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Economic Forecasting Project

Old Dominion University
2013 National Economic Outlook

January 30, 2013

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www.odu.edu/forecasting

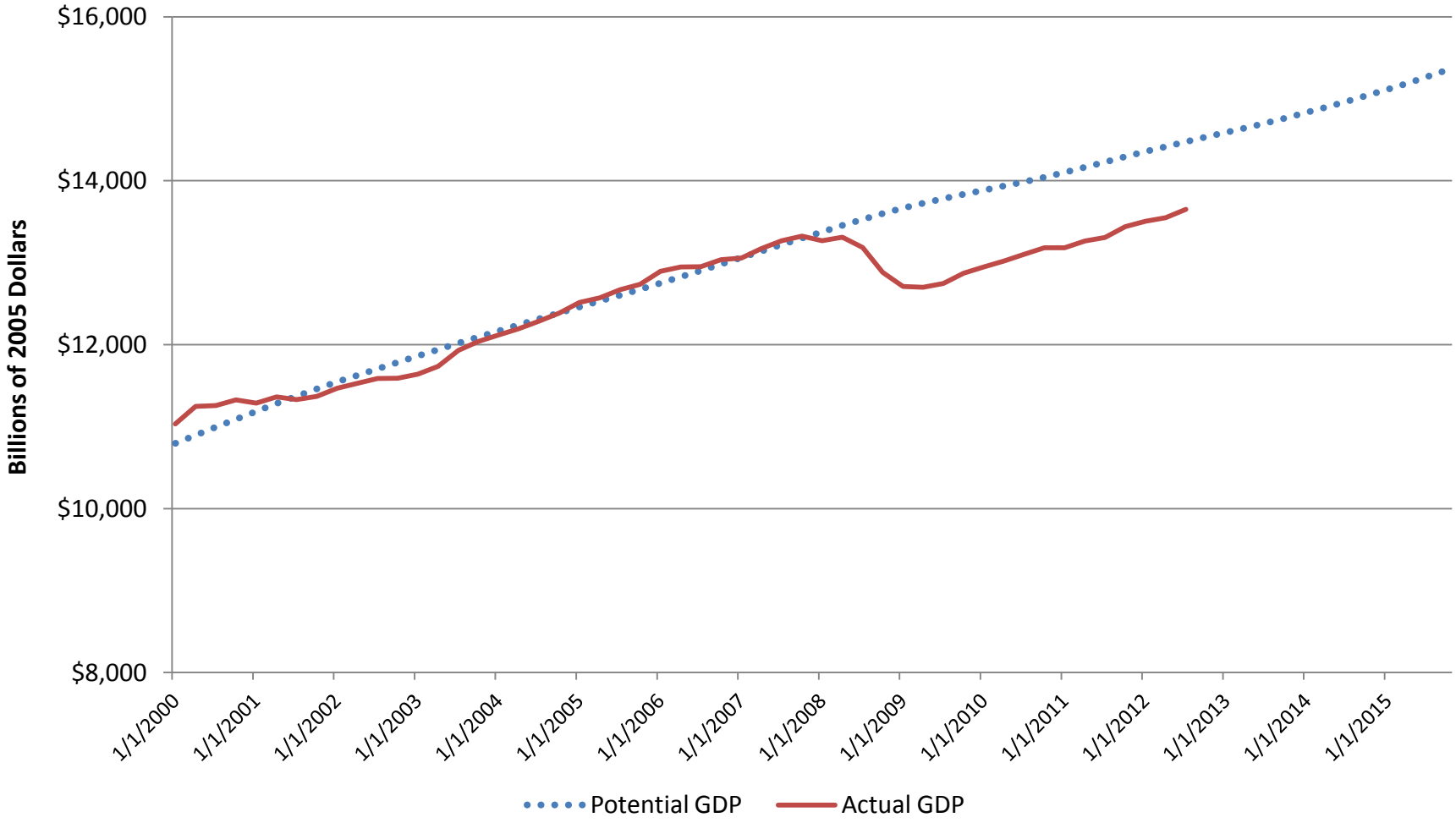
Presentation Outline

- 2012 Scorecard
- Current economic conditions
- Outlook for 2013
 - What are the likely sources for growth?
- Monetary Policy
- Downside Risks
- Upside risks

2012 Scorecard

	2012 Forecast	2012 Actual
Real Gross Domestic Product (GDP)	2.40%	2.26%
Employment	2.00%	1.38%
Unemployment rate	7.9%	8.1%
Consumer Price Index (CPI)	2.30%	1.74%
CPI – Core	2.10%	1.89%
3-month Treasury bill	0.50%	0.09%
10-year Treasury bond	1.90%	1.80%
30-year conventional mortgage	3.80%	3.66%

Potential and Actual (Real) Gross Domestic Product, 2000-2015

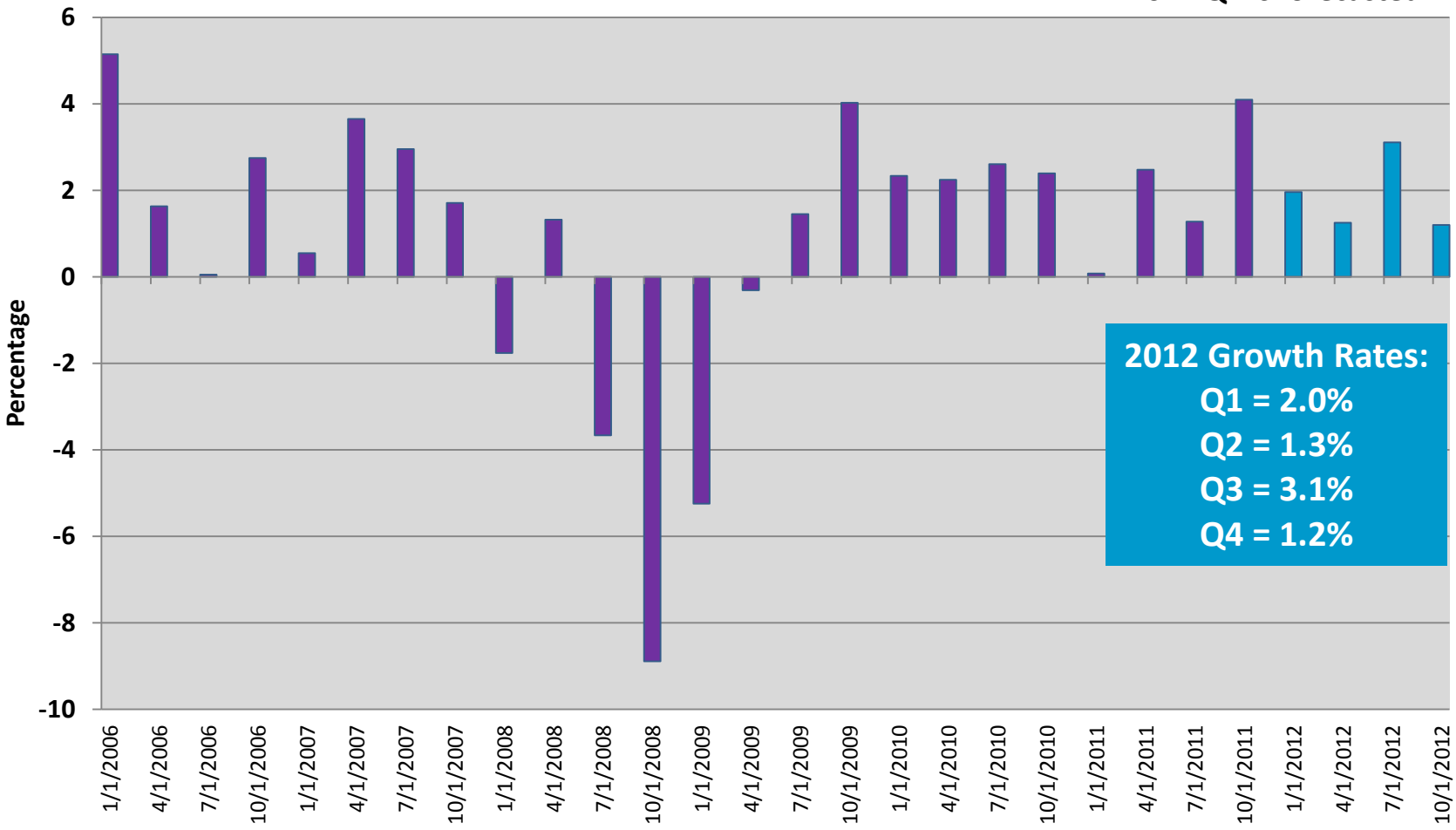


Source: Bureau of Economic Analysis and Old Dominion University Economic Forecasting Project.

Growth in Real Gross Domestic Product (GDP), 2006:Q1 – 2012:Q4

Seasonally adjusted annualized rate *100

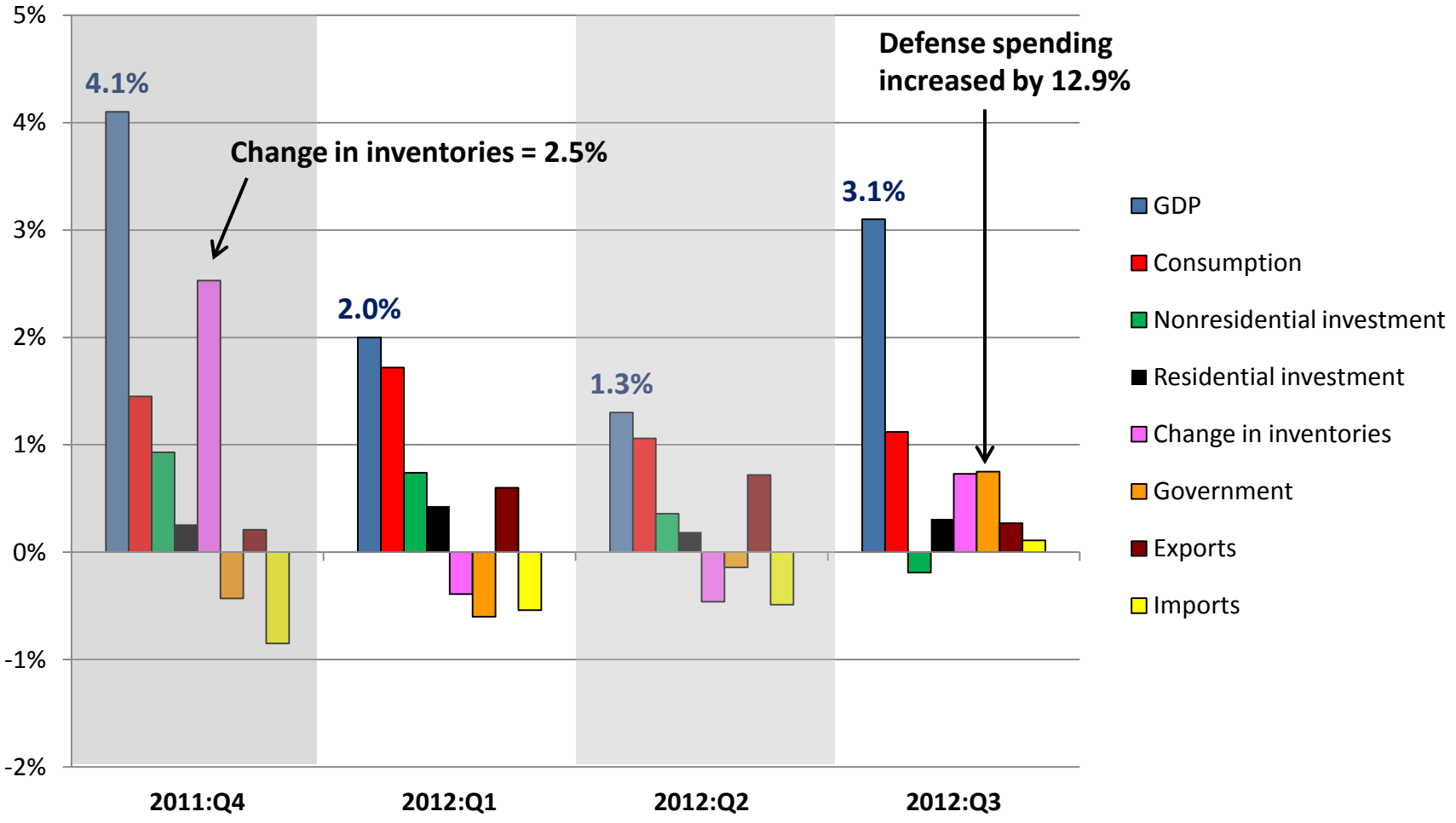
2012:Q4 is forecasted.



Source: Bureau of Economic Analysis and Old Dominion University Economic Forecasting Project.

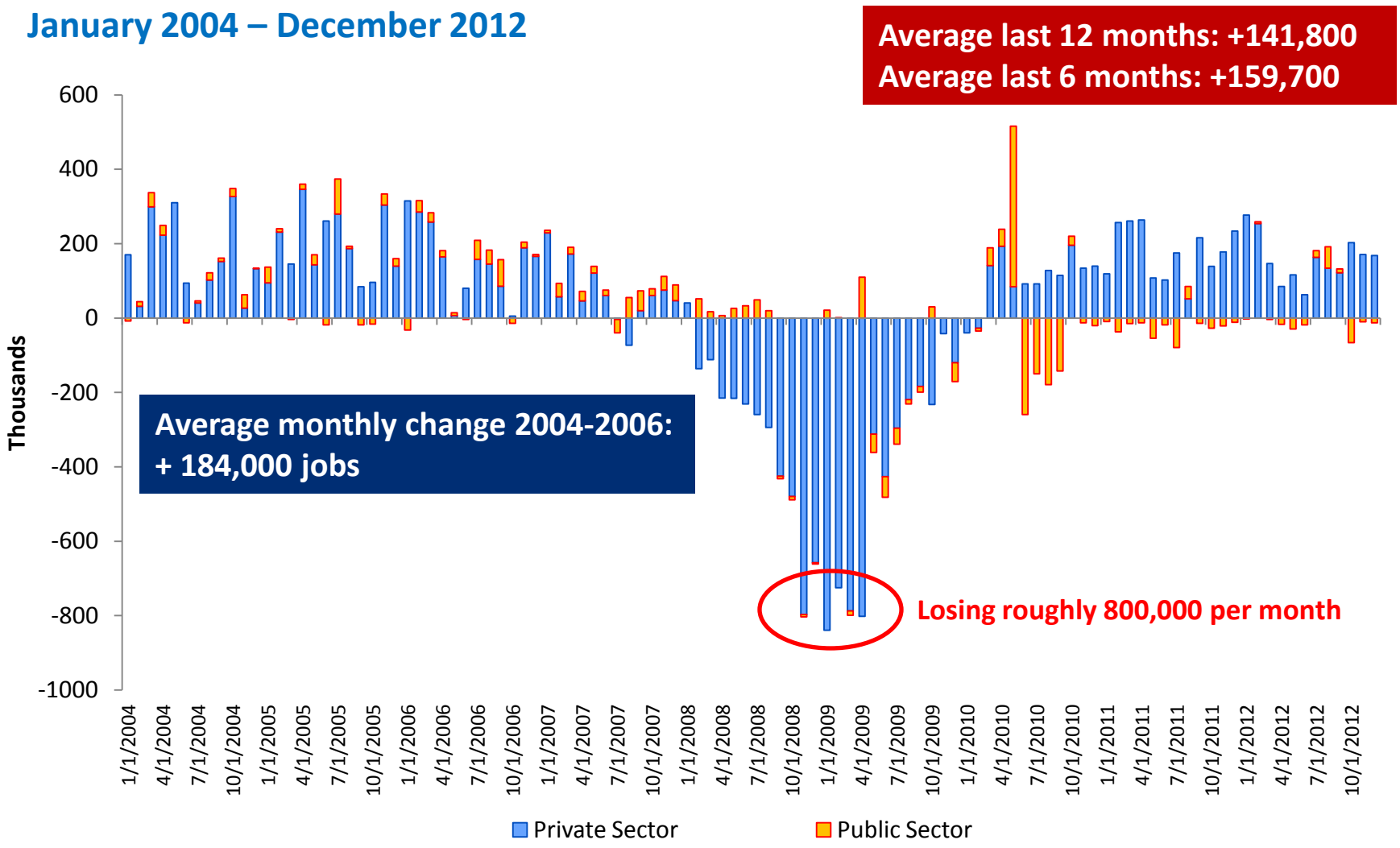
Where has GDP growth been coming from?

Last Four Quarters, seasonally adjusted annualized rate



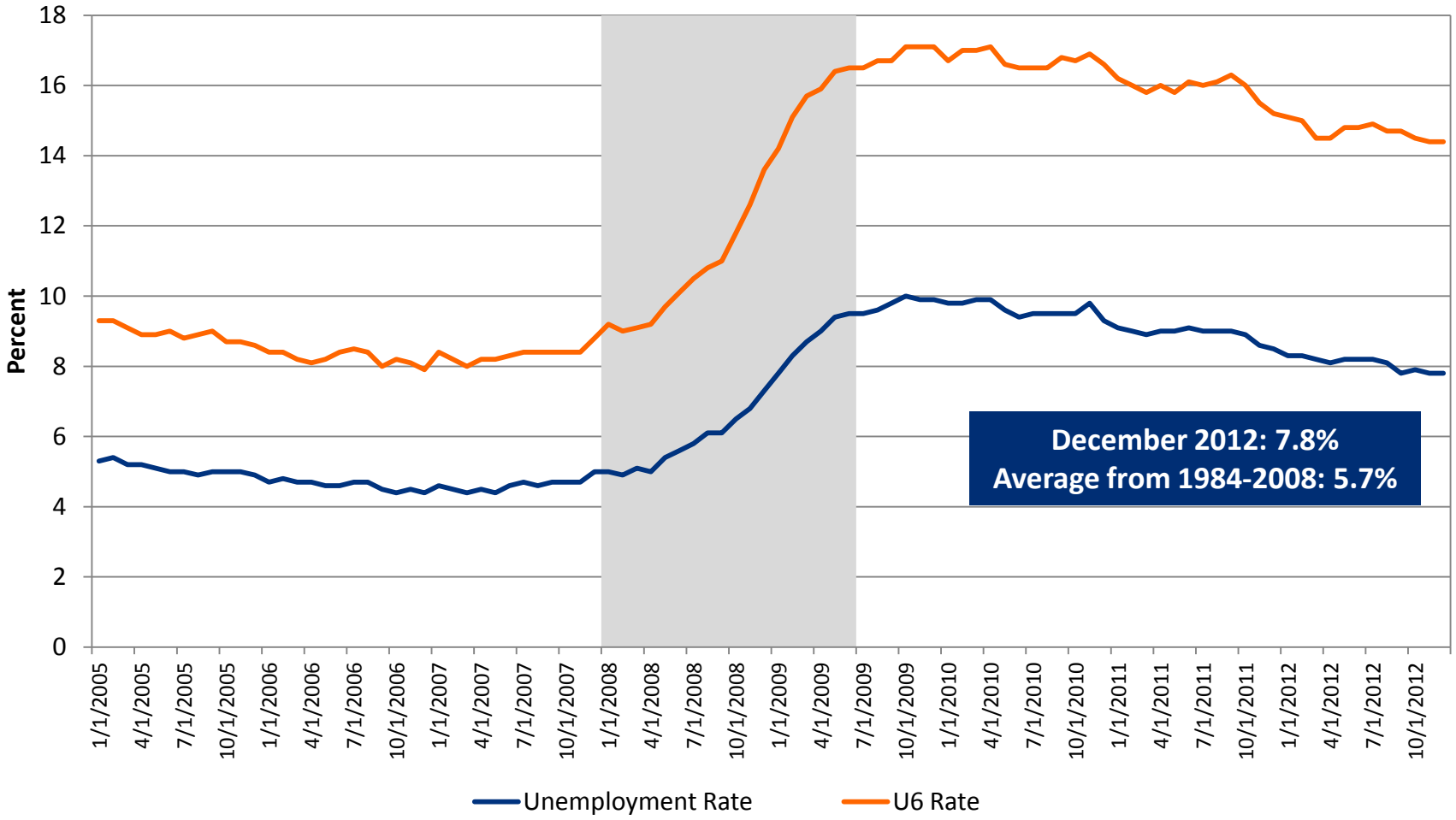
Source: Bureau of Economic Analysis and Old Dominion University Economic Forecasting Project.

Month-to-Month Change in US Total Nonfarm Employment



Source: Bureau of Labor Statistics and Old Dominion University Economic Forecasting Project.

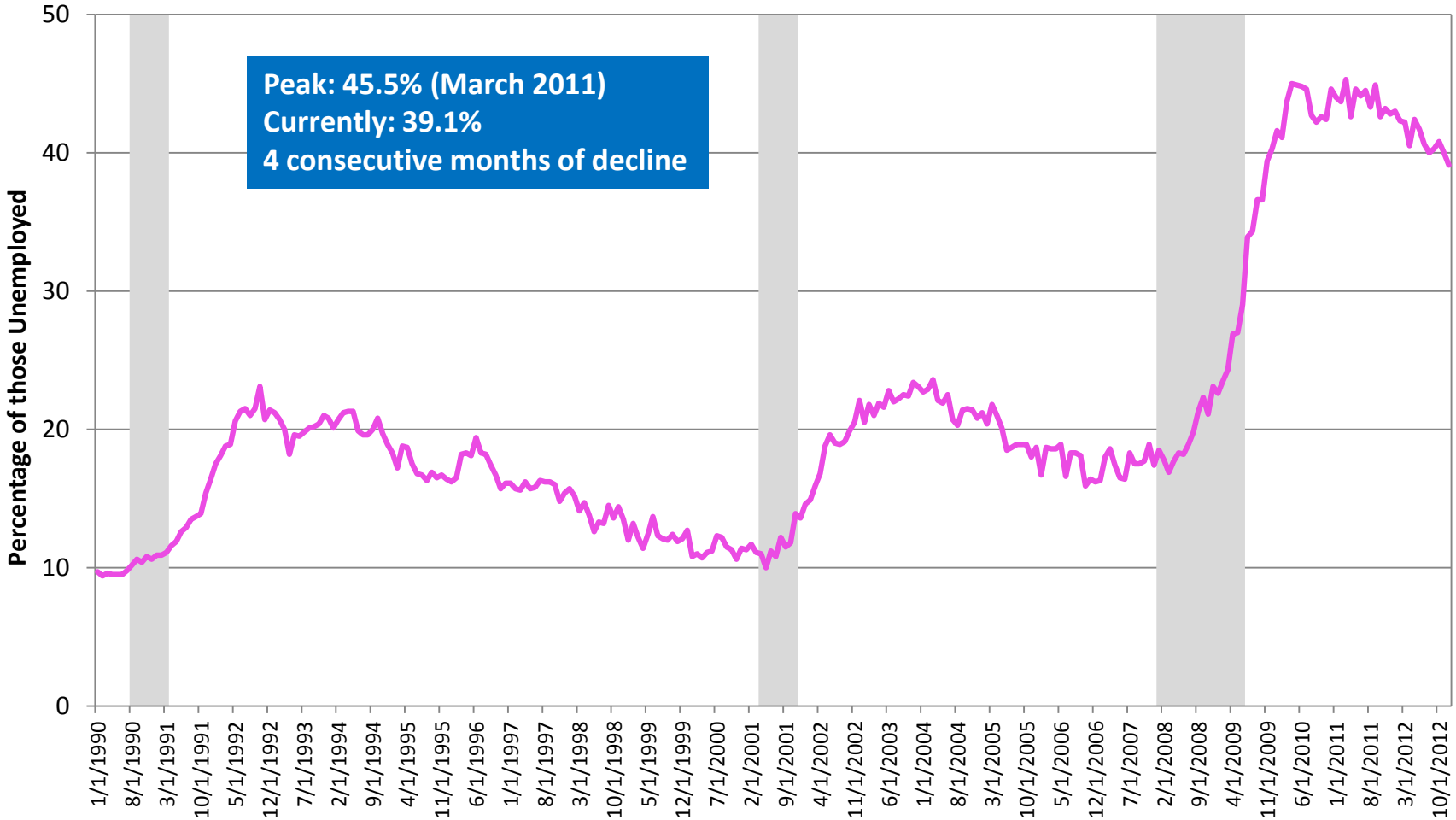
US Unemployment Rate, January 2005 – December 2012



Source: Bureau of Labor Statistics and Old Dominion University Economic Forecasting Project.

Long-Term Unemployment, 1990-present

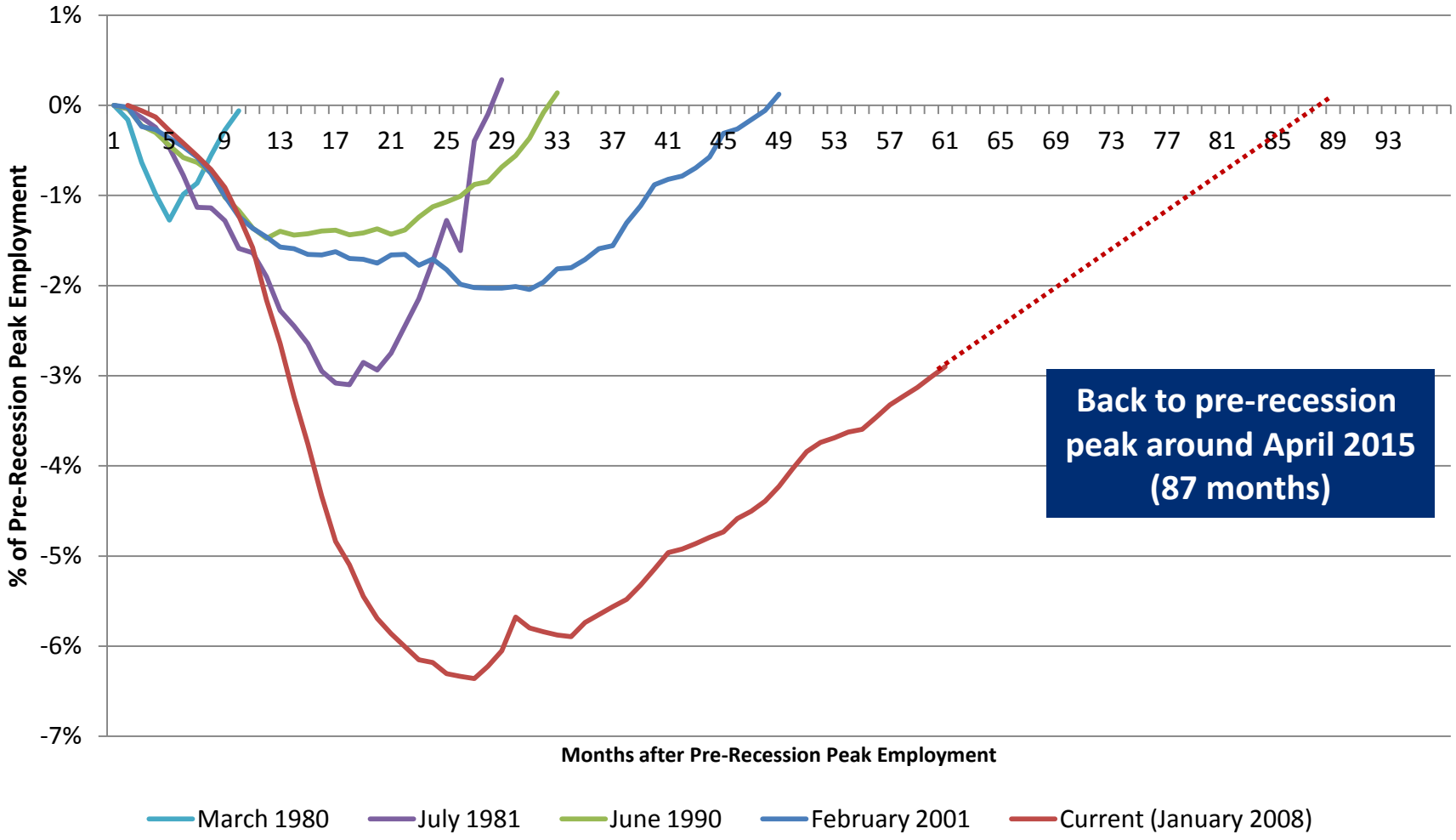
Of Total Unemployed, Percentage Unemployed for *27 Weeks or Longer*



Source: Bureau of Labor Statistics and Old Dominion University Economic Forecasting Project.

The 2007-2009 Recession in Perspective

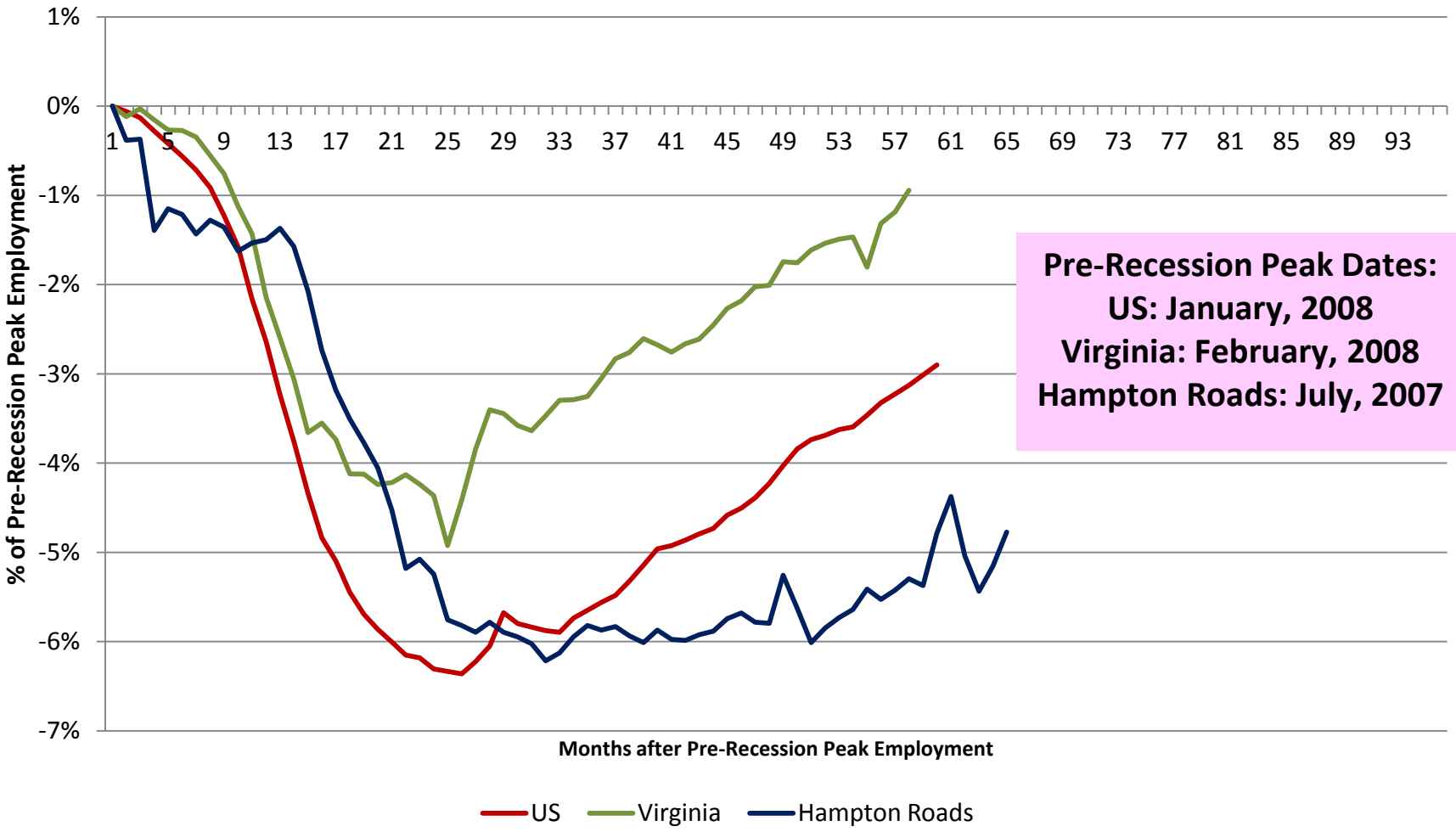
% Decline in Total US Non-farm Payroll Employment from Pre-Recession Peak



Source: Bureau of Labor Statistics and Old Dominion University Economic Forecasting Project

The 2007-2009 Recession Including Virginia and Hampton Roads

% Decline in Total US Non-farm Payroll Employment from Pre-Recession Peak

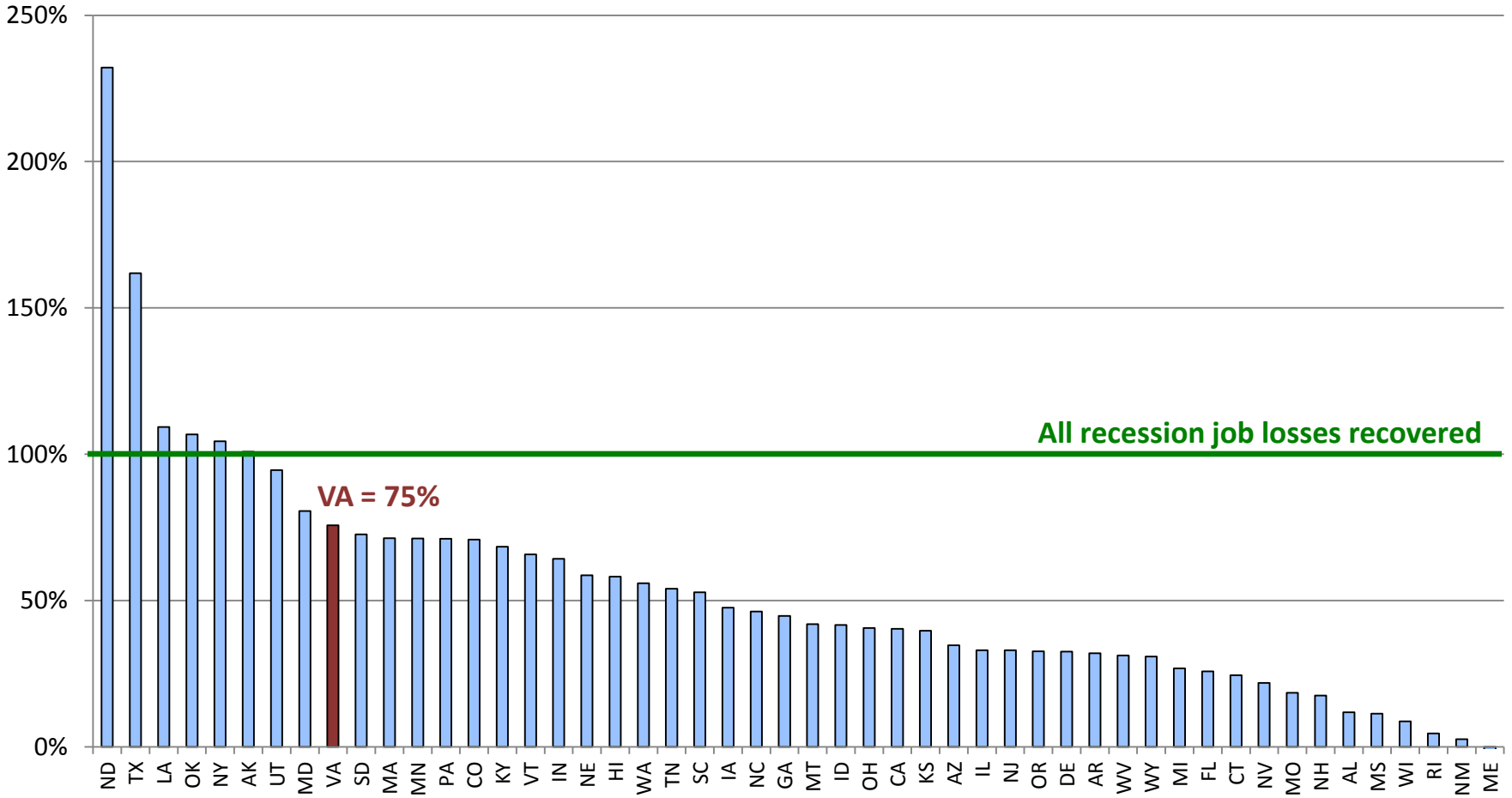


Pre-Recession Peak Dates:
US: January, 2008
Virginia: February, 2008
Hampton Roads: July, 2007

Source: Bureau of Labor Statistics and Old Dominion University Economic Forecasting Project

Percentage of 'Great Recession' Job Losses Recovered, by State

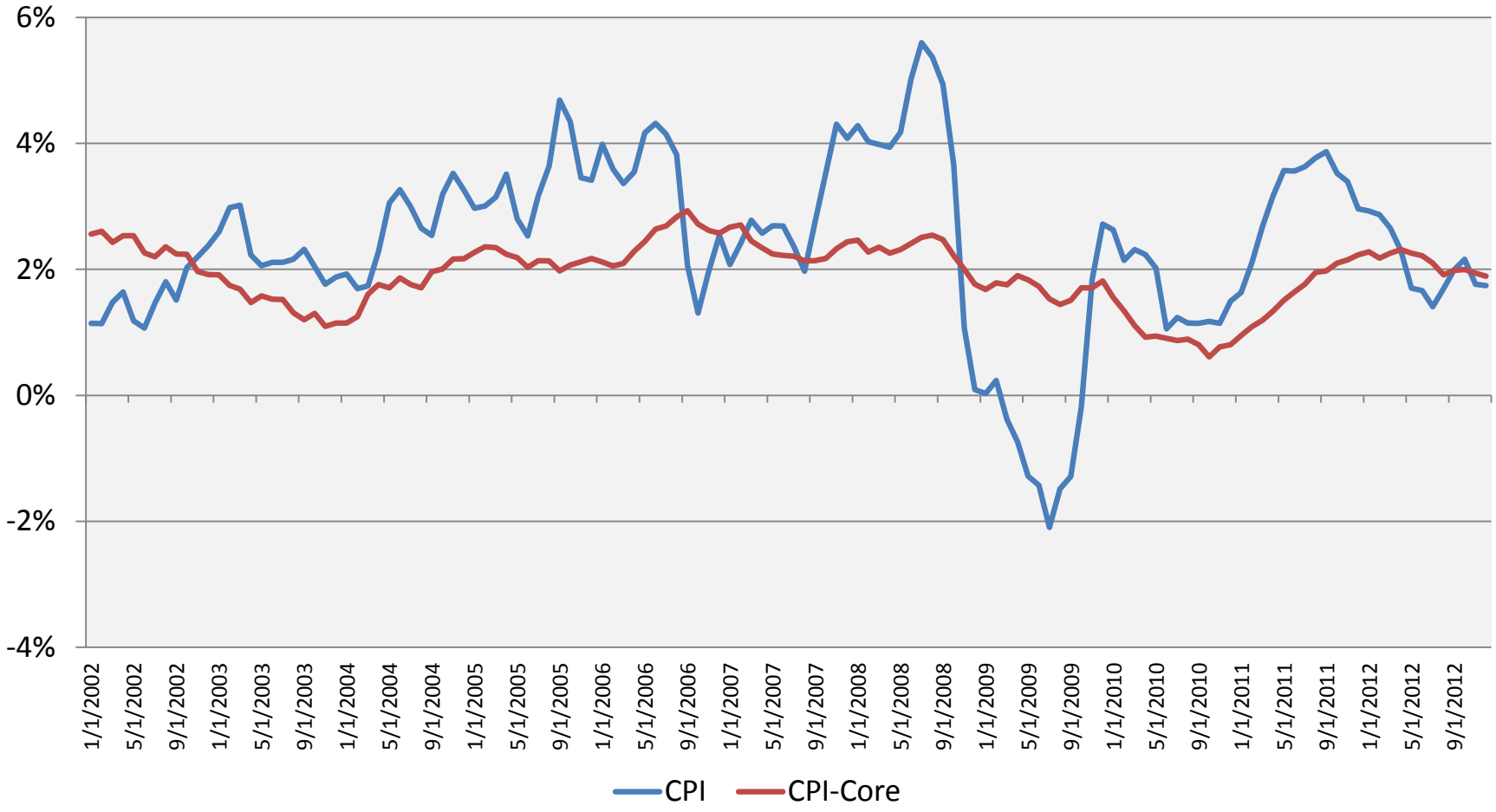
As of December 2012



Source: Bureau of Labor Statistics and Old Dominion University Economic Forecasting Project

CPI and CPI-Core, January 2002 – December 2012

12-Month Percentage change



Source: Bureau of Labor Statistics and Old Dominion University Economic Forecasting Project

National Outlook for 2013

	2013 Forecast
Real Gross Domestic Product (GDP)	2.10%
Employment	1.15%
Unemployment rate	7.6%
Consumer Price Index (CPI)	1.73%
CPI – Core	1.51%
3-month Treasury bill	0.20%
10-year Treasury bond	1.95%
30-year conventional mortgage	3.80%

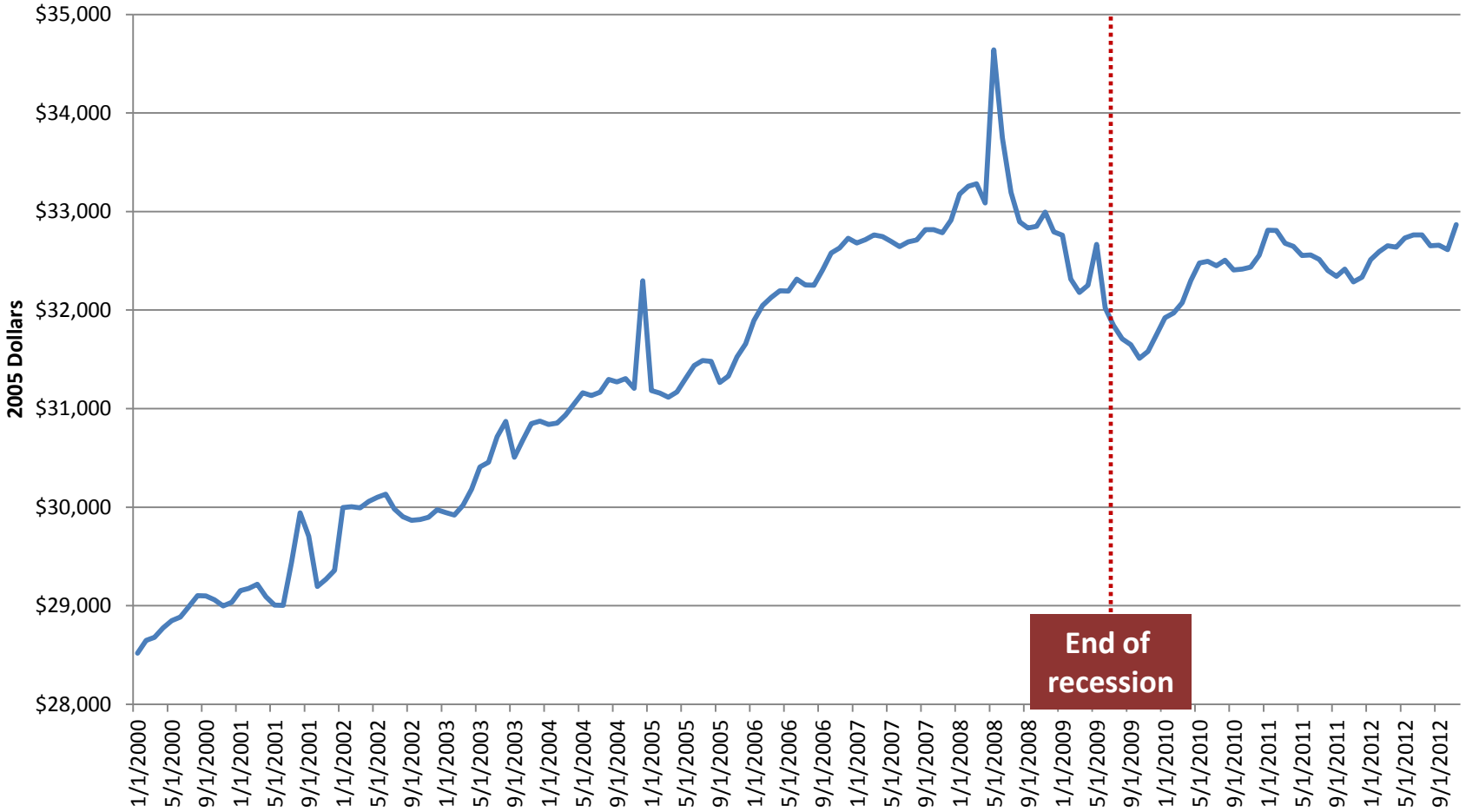
What are the likely sources for growth?

- Gross Domestic Product (GDP) is comprised of 4 components:
 1. Consumption
 2. Investment
 3. Net exports
 4. Government

Consumption (or "Personal Consumption Expenditures")

- Almost 71% of GDP
- Primarily driven by income, employment, wealth
- We expect consumption will continue to "limp along" in 2013

Real Disposable Income Per Person, 2000 – present

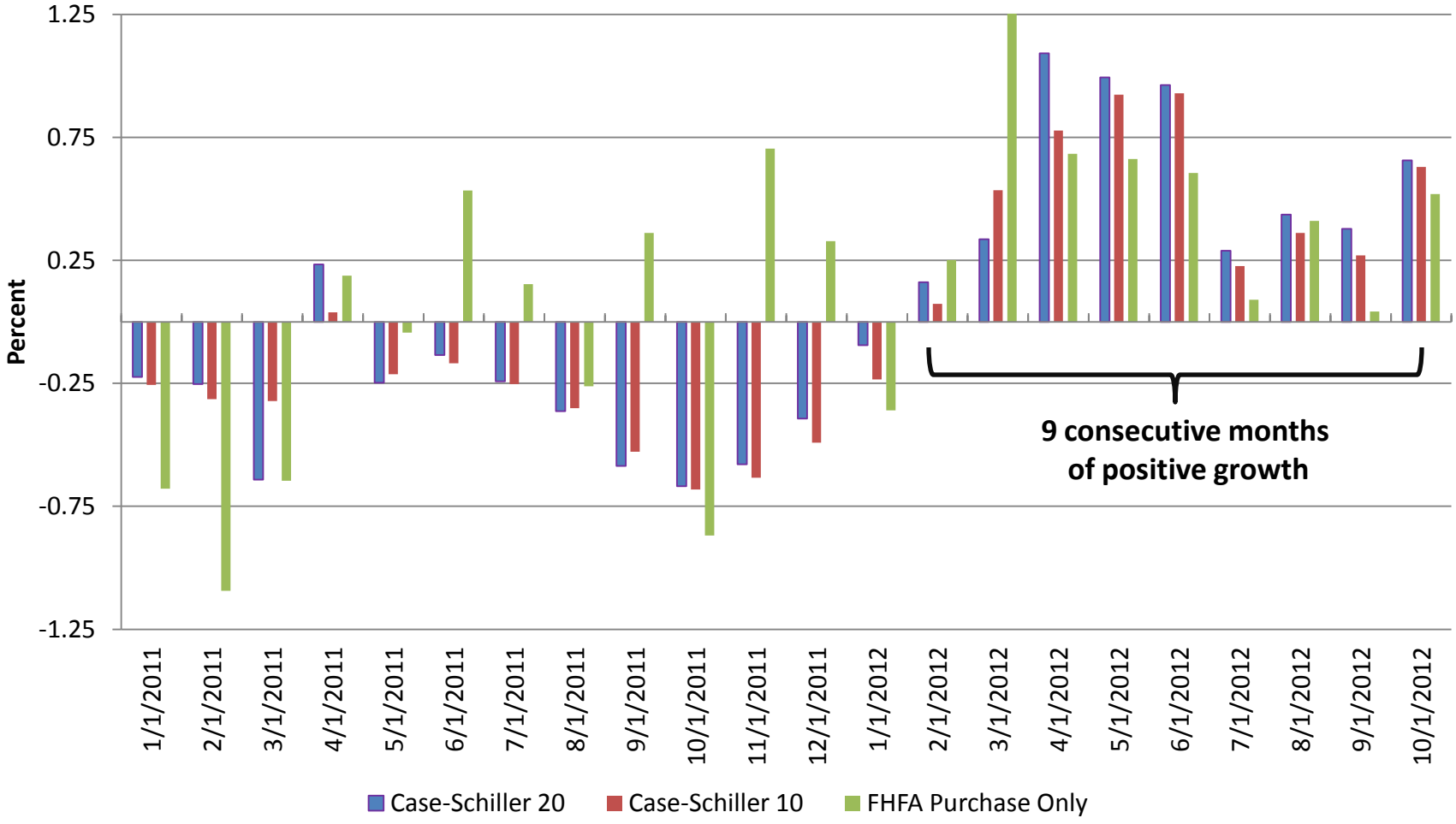


Source: Bureau of Economic Analysis.

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Nominal Home Price Growth in 2011 and 2012

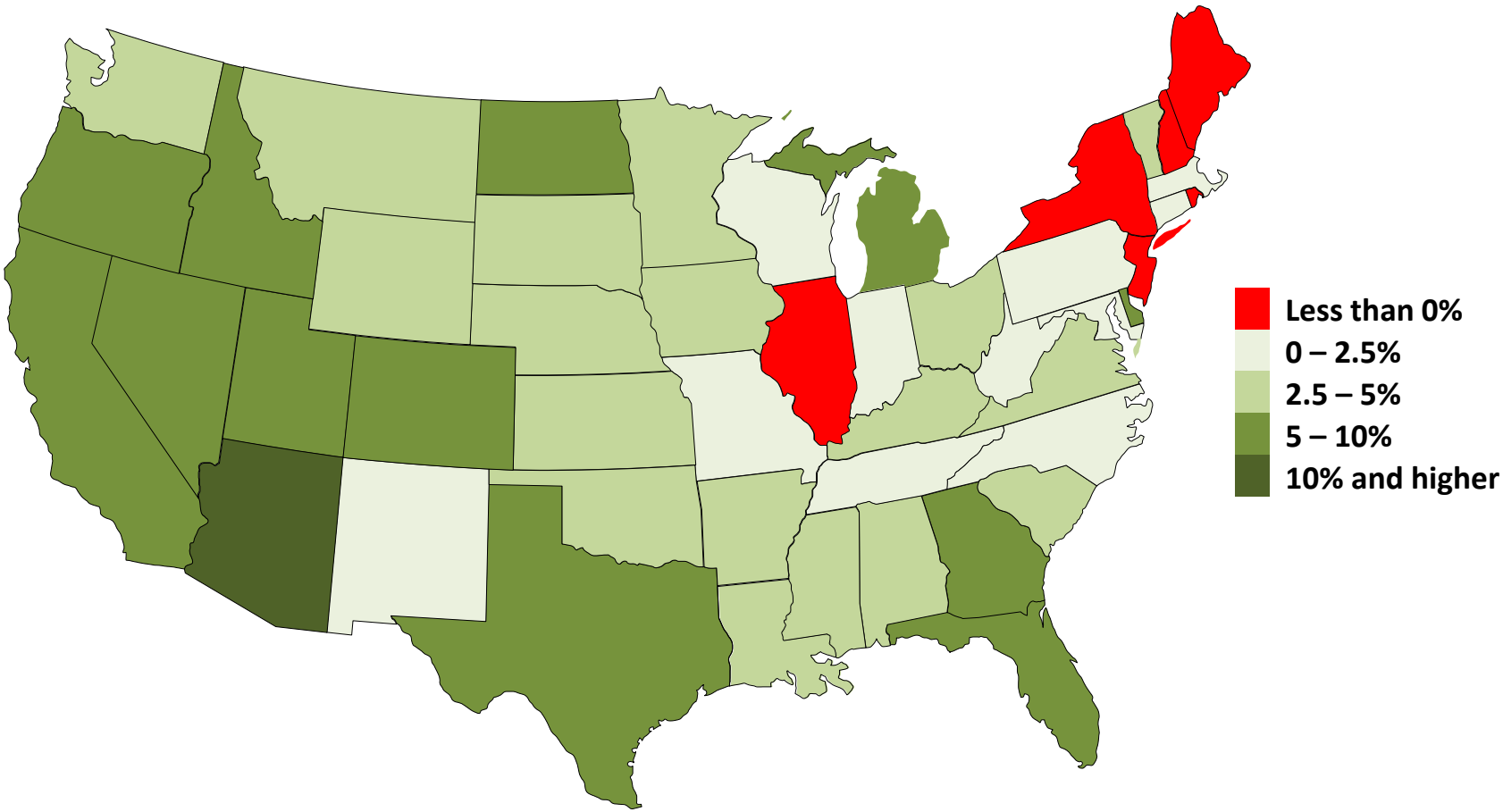
Monthly Percentage Change in Selected Indices, Jan. 2011 – Oct. 2012



Source: Standard and Poor's, FHFA, and Old Dominion University Forecasting Project.

Year-Over-Year Nominal Home Prices, 2011:Q3 - 2012:Q3

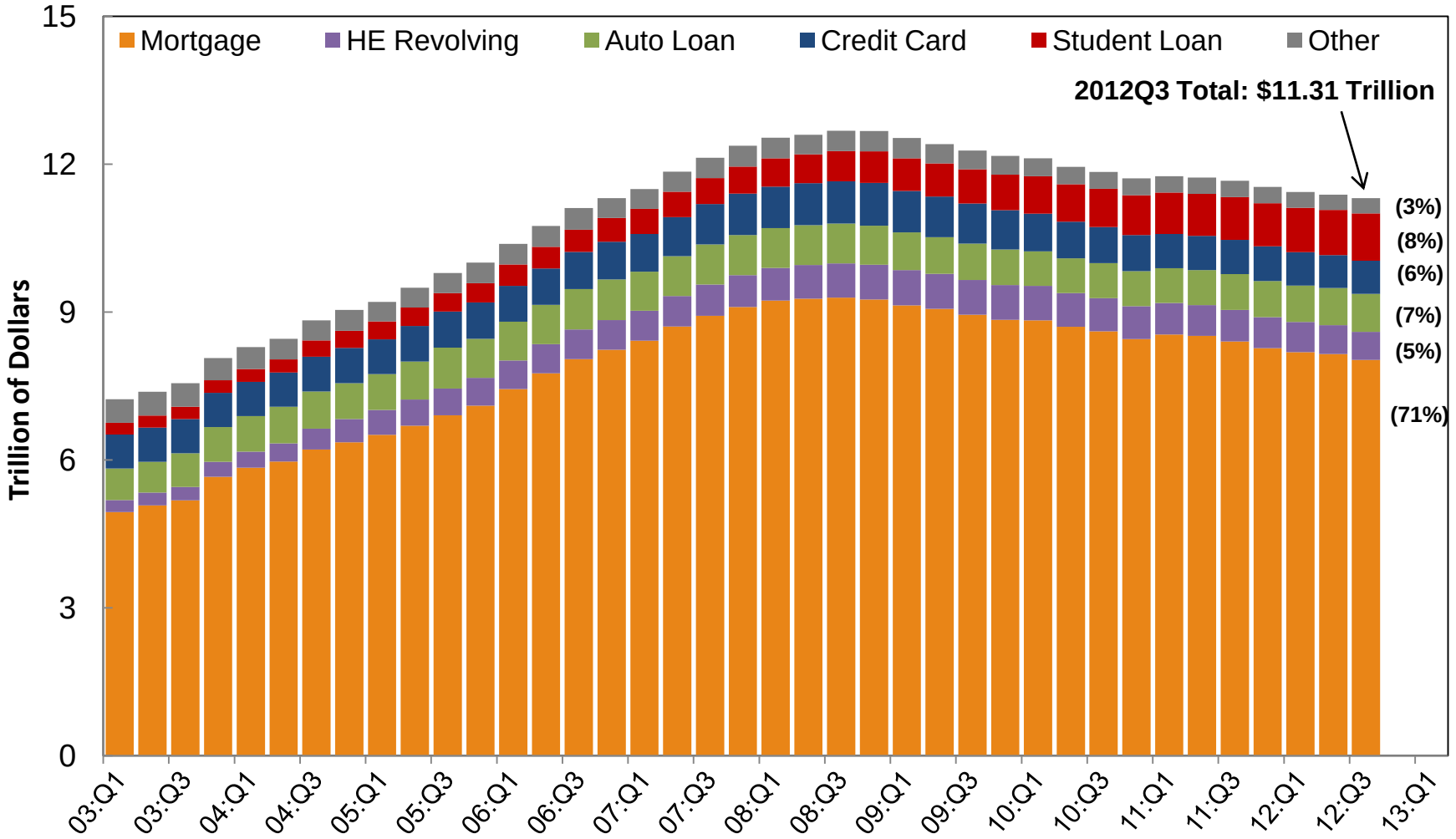
% Change in FHFA All Transactions Index (Seasonally Adjusted)



Source: FHFA and Old Dominion University Economic Forecasting Project

Economic Forecasting Project

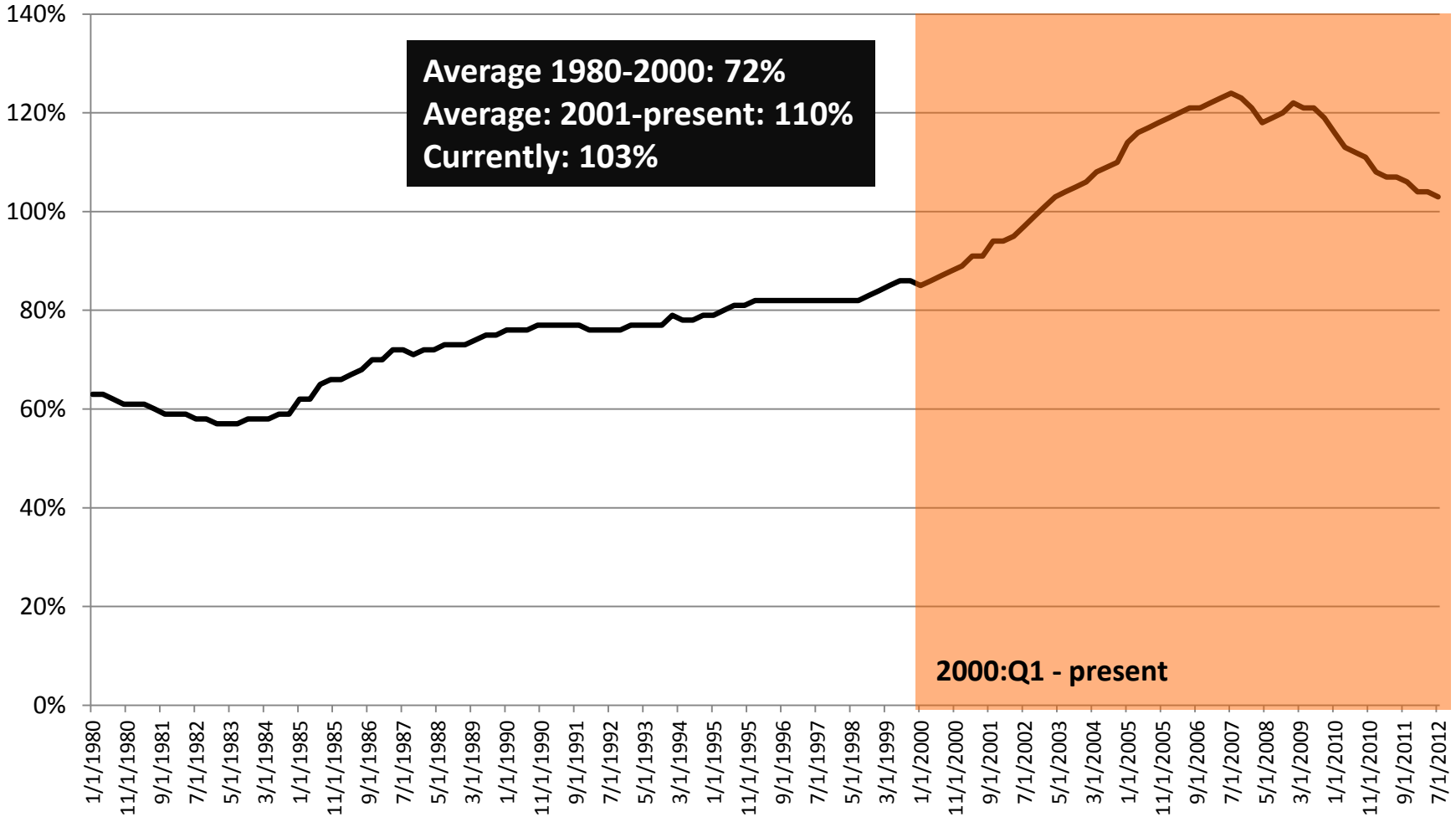
Total Household Debt Balance, 2003:Q1 – 2012:Q3



Source: Federal Reserve Bank of New York Quarterly Report on Household Debt and Credit.

Household Debt-to-Income, 1980:Q1 – 2012:Q3

Mortgage & Consumer Credit Debt to Disposable Income



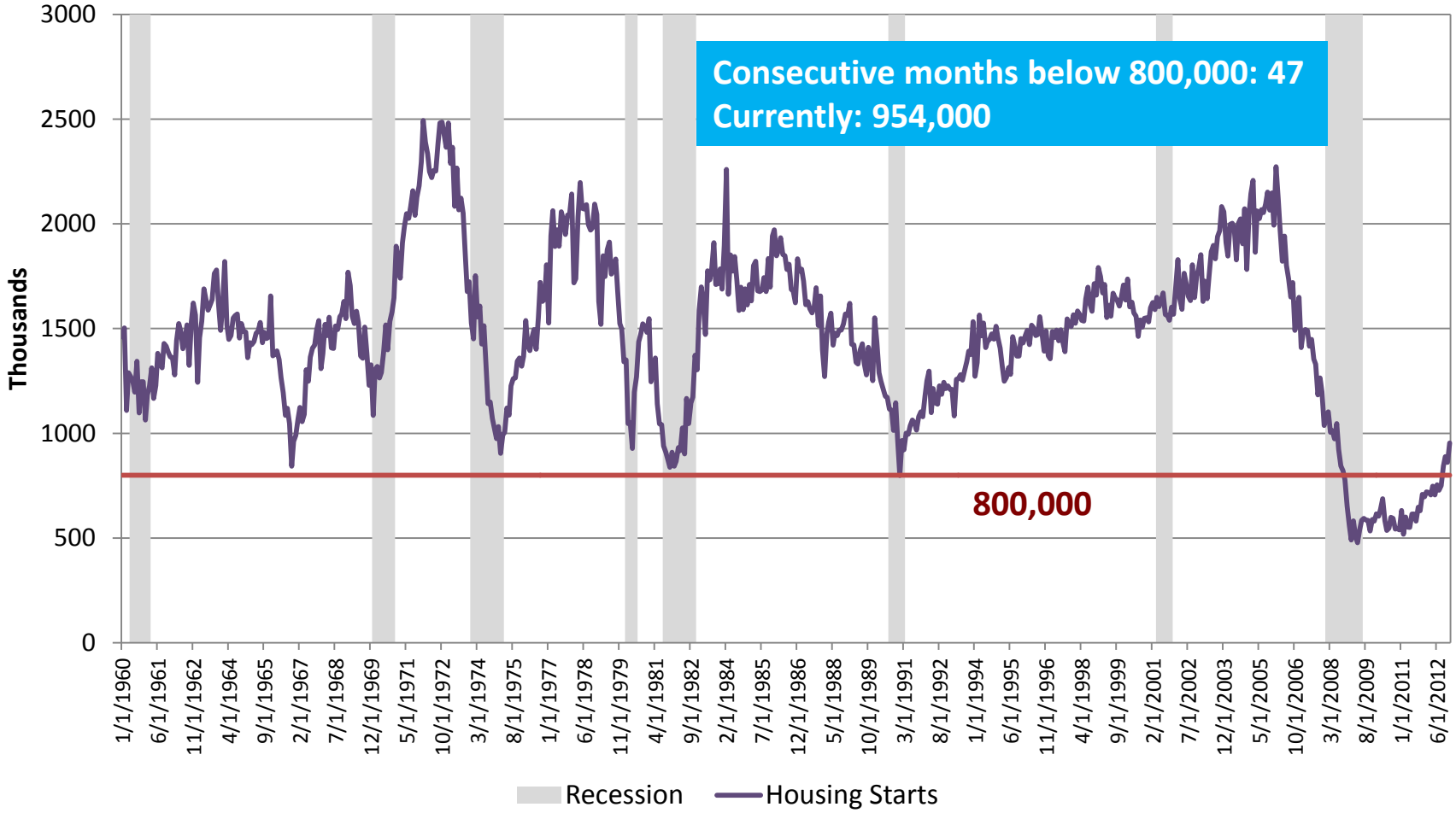
Source: Board of Governors of the Federal Reserve and Bureau of Economic Analysis.

Investment (or "Private Fixed Investment")

- Residential investment (**2.5% of GDP**)
 - Construction of single- and multi-family housing units
- Nonresidential investment (**10% of GDP**)
 - Firm purchases of structures, equipment, and software that are used in the production of goods and services
- Change in inventories (**0.3% of GDP**)
- Primarily driven by interest rates, expectations, and the availability of credit

Housing Starts: New Privately Owned Units, 1960 –present

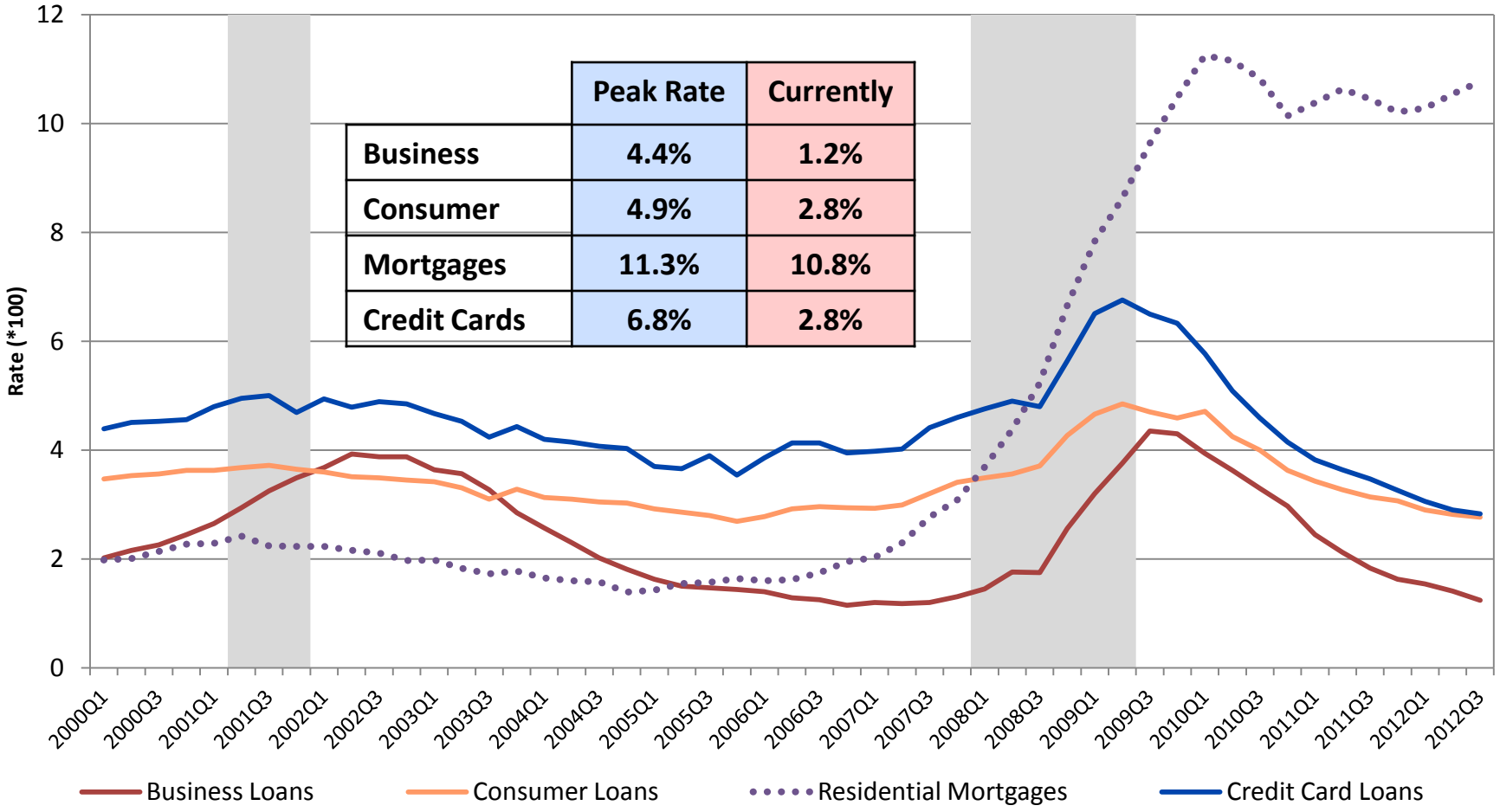
Seasonally adjusted annual rate, 1960:Q1 – 2012:Q4



Source: US Department of Commerce.

Commercial Bank Loan Delinquency Rates

2000:Q1 – 2012:Q3

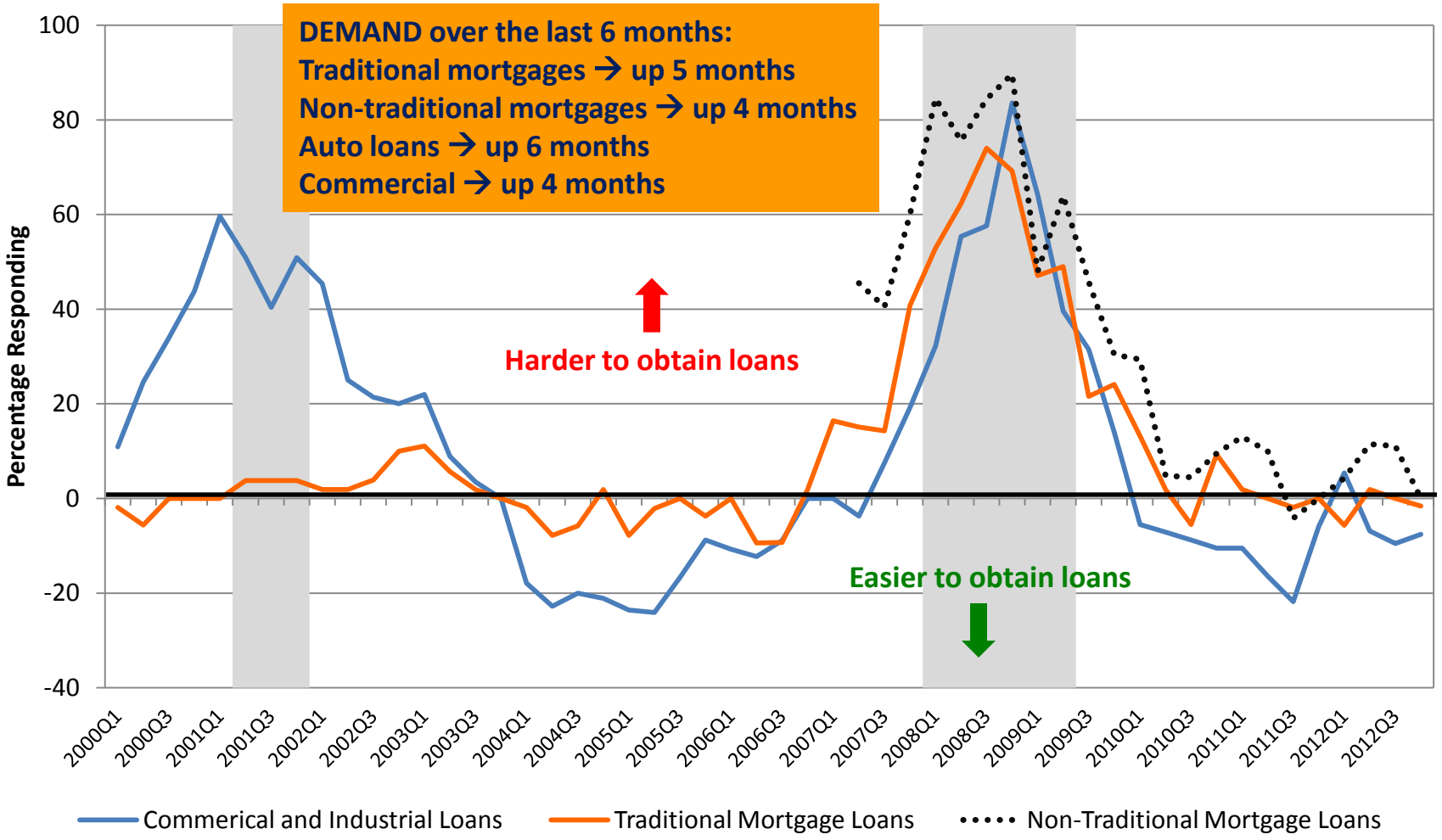


	Peak Rate	Currently
Business	4.4%	1.2%
Consumer	4.9%	2.8%
Mortgages	11.3%	10.8%
Credit Cards	6.8%	2.8%

Source: Federal Reserve Board of Governors and Old Dominion University Economic Forecasting Project.

Bank-Reported Lending Standards

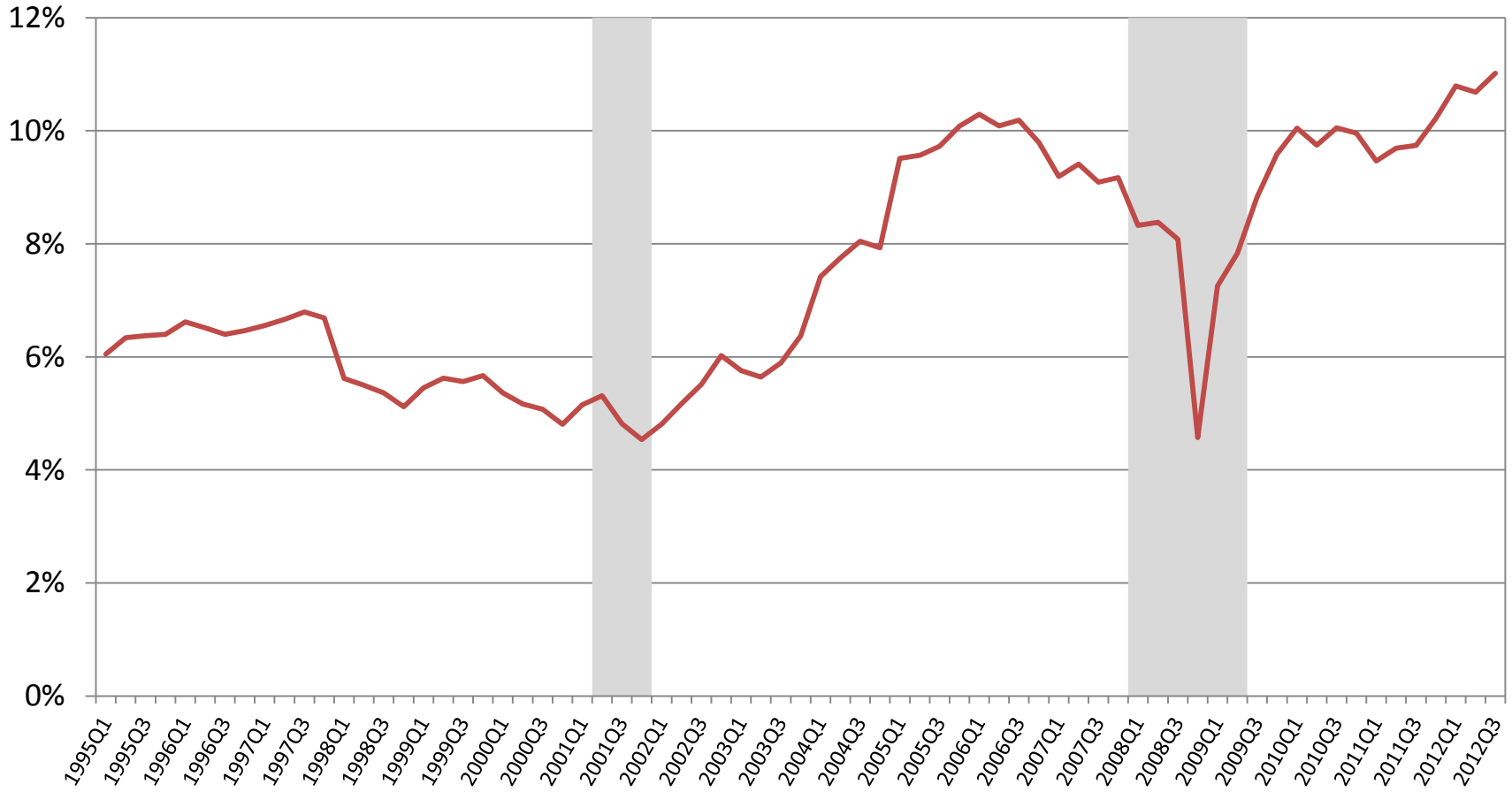
Federal Reserve Senior Loan Officer Opinion Survey, 2001:Q1 to 2012:Q3



Source: Federal Reserve Board of Governors and Old Dominion University Economic Forecasting Project.

Corporate After-Tax Profits, 1995:Q1 – 2012:Q3

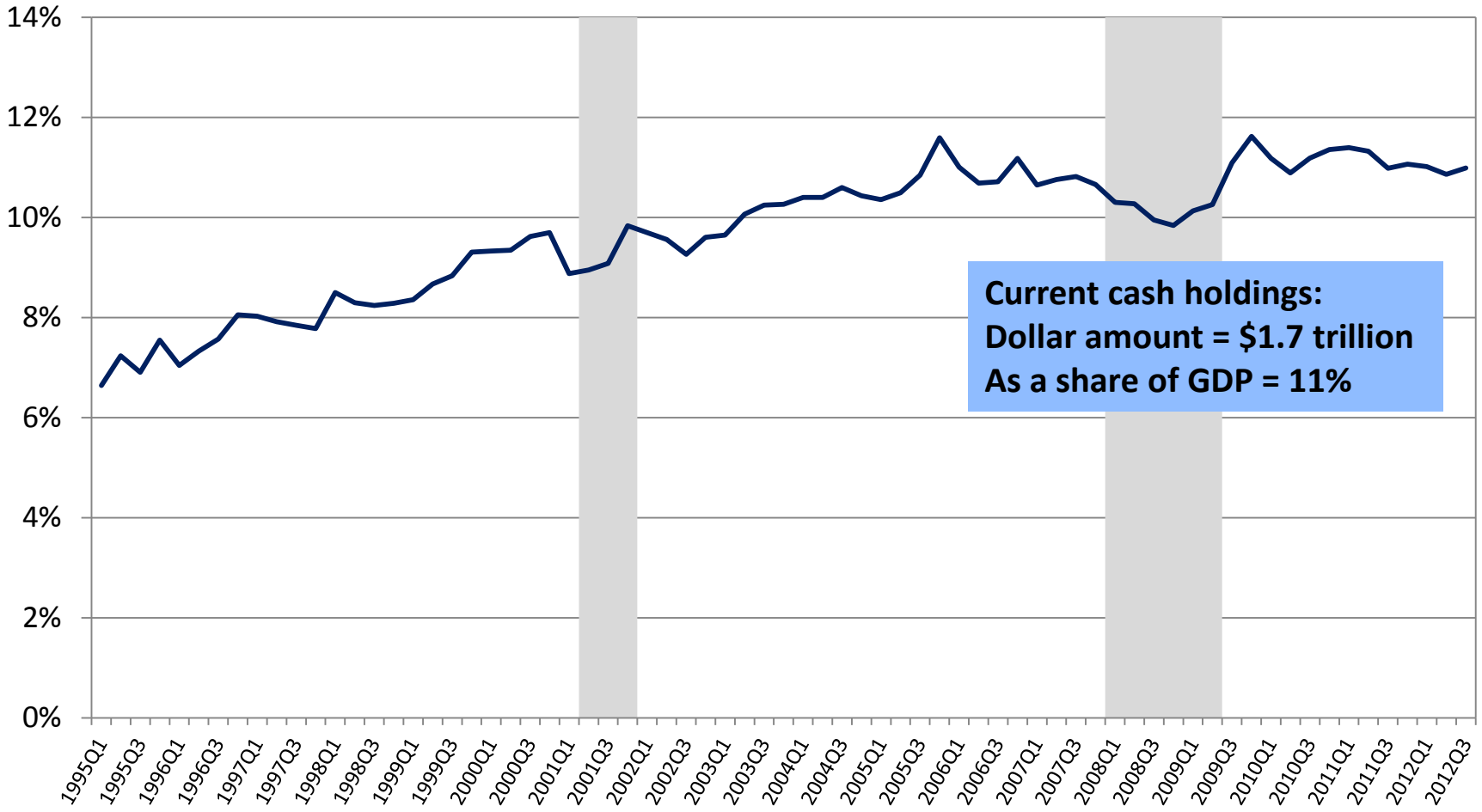
As a percentage of GDP



Source: Bureau of Economic Analysis and Old Dominion University Economic Forecasting Project.

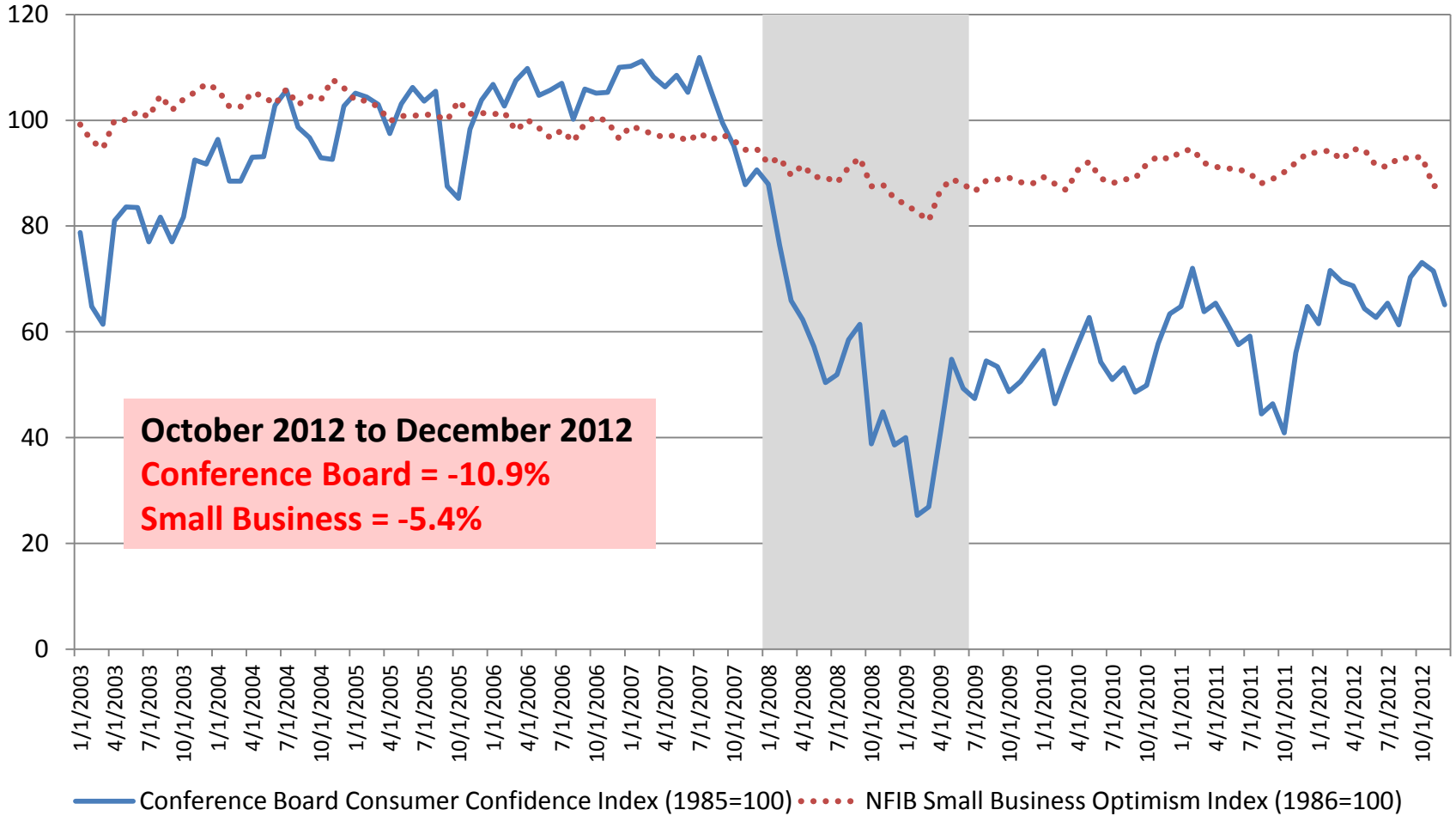
Nonfinancial Corporate Cash Holdings, 1995:Q1 – 2012:Q3

As a percentage of GDP



Source: Federal Reserve Board of Governors and Old Dominion University Economic Forecasting Project.

Limping Out of 2012?



Sources: Conference Board, National Federal of Independent Business, and Old Dominion University Economic Forecasting Project.

Net Exports (or "exports less imports")

- Primarily driven by domestic economic conditions, economic conditions of our trading partners, and exchange rates

Top Trading Partners in Goods, 2012 (through November)

	Exports (billions)	Imports (billions)	Percent of Total Trade
Canada	270.1	298.4	16.2%
China	100.2	390.8	14.0%
Mexico	199.9	257.3	13.0%
Japan	64.0	134.6	5.7%
Germany	45.0	99.3	4.1%
United Kingdom	50.8	50.6	2.9%
South Korea	38.9	54.3	2.7%
Brazil	40.2	29.9	2.0%
Saudi Arabia	16.2	52.0	1.9%
France	28.4	38.3	1.9%

Outlook for Net Exports in 2013

- Slowing growth around the world
 - China, Japan, India, Latin America
- Reasons to be concerned about Europe
 - Recession/near-zero growth
 - Are they committed to their sovereign debt solutions?
- Canada and Mexico are performing about the same as US
 - No MAJOR stimulus likely

Government ("Government Consumption & Investment")

- State and local sector (**12% of GDP**)
 - 50% larger than Federal government
 - Good news: budgets are starting to grow (slowly)
 - Bad news: FY13 spending projected to be lower in 24 states than in 2008

- Federal government (**8% of GDP**)
 - Stimulus packages of 2008 and 2010 have been fully exhausted
 - The largest source of economic uncertainty?
 - American Taxpayer Relief Act of 2012
 - Debt limit

American Taxpayer Relief Act of 2012 ("fiscal cliff" deal)

Major revenue changes

For individuals earning over $400,000 per year (couples over $450K):

- Marginal tax rates increased from 35% to 39.6%
- Long-term capital gains & dividends increased from 15% to 20%

- Top tax rate on estates over $5.12 million will be 40%

- **AMT exemption is indexed to inflation**

- **Social Security payroll tax reduction expired**

- Child tax credit, EITC, and education credits extended until 2017

- R&D and investment expensing allowances extended to 2013

American Taxpayer Relief Act of 2012 ("fiscal cliff" deal)

Major expenditure changes

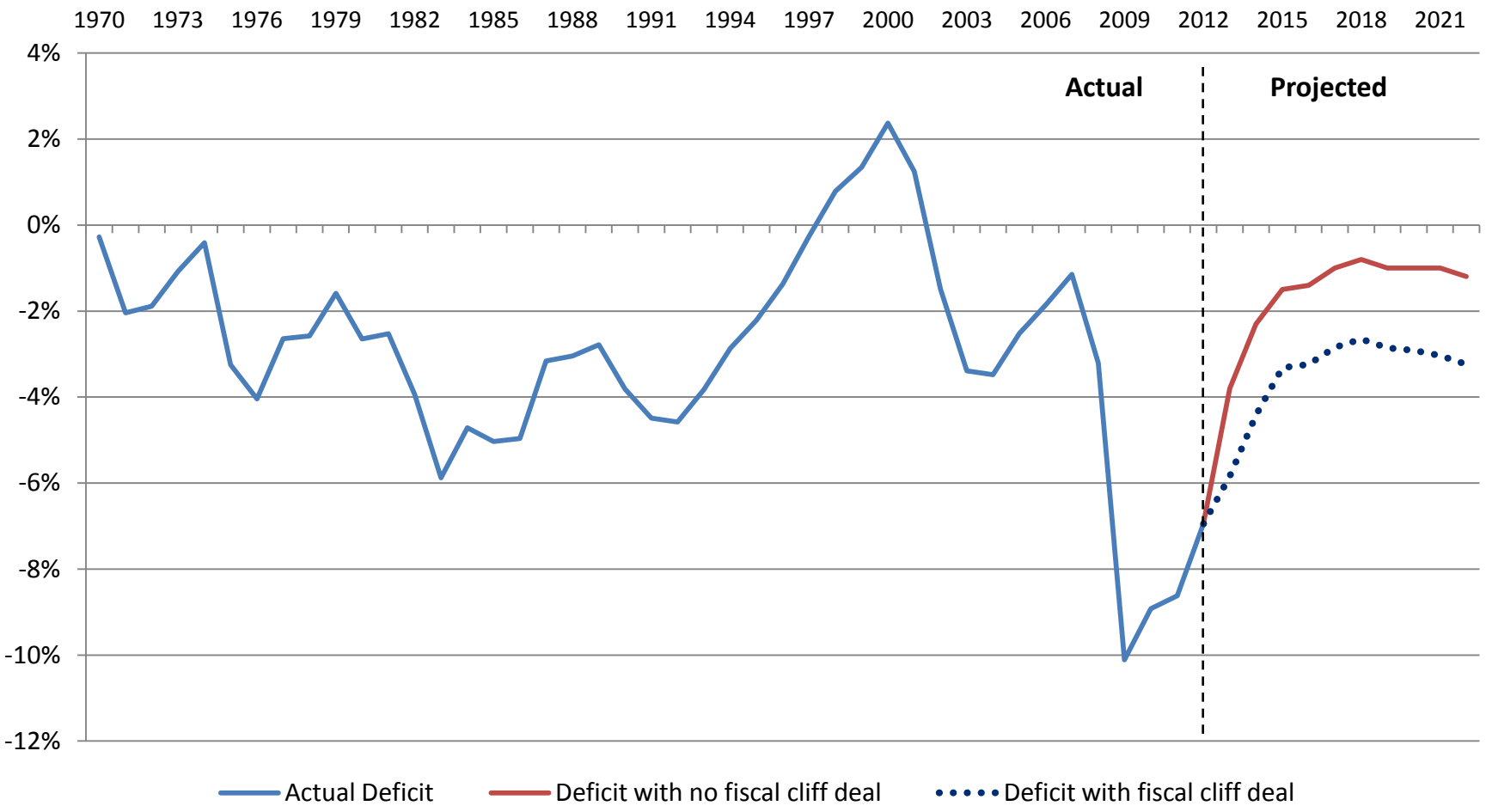
- Federal unemployment insurance extensions carry into 2013
- Extend Medicare physician payments (would have reduce payments by 27% in FY13)

Planned spending reductions of $109.4 billion in FY2013 (*Sequestration*)

- **A one-time $54.7 billion in defense and $54.7 billion in non-defense**
- **Changed to a $42.5 billion reduction in FY2013 and a $12.2 reduction in FY2014**
- **Initial impact delayed until March 1, 2013**

Federal Budget Deficits, 1970 – 2022

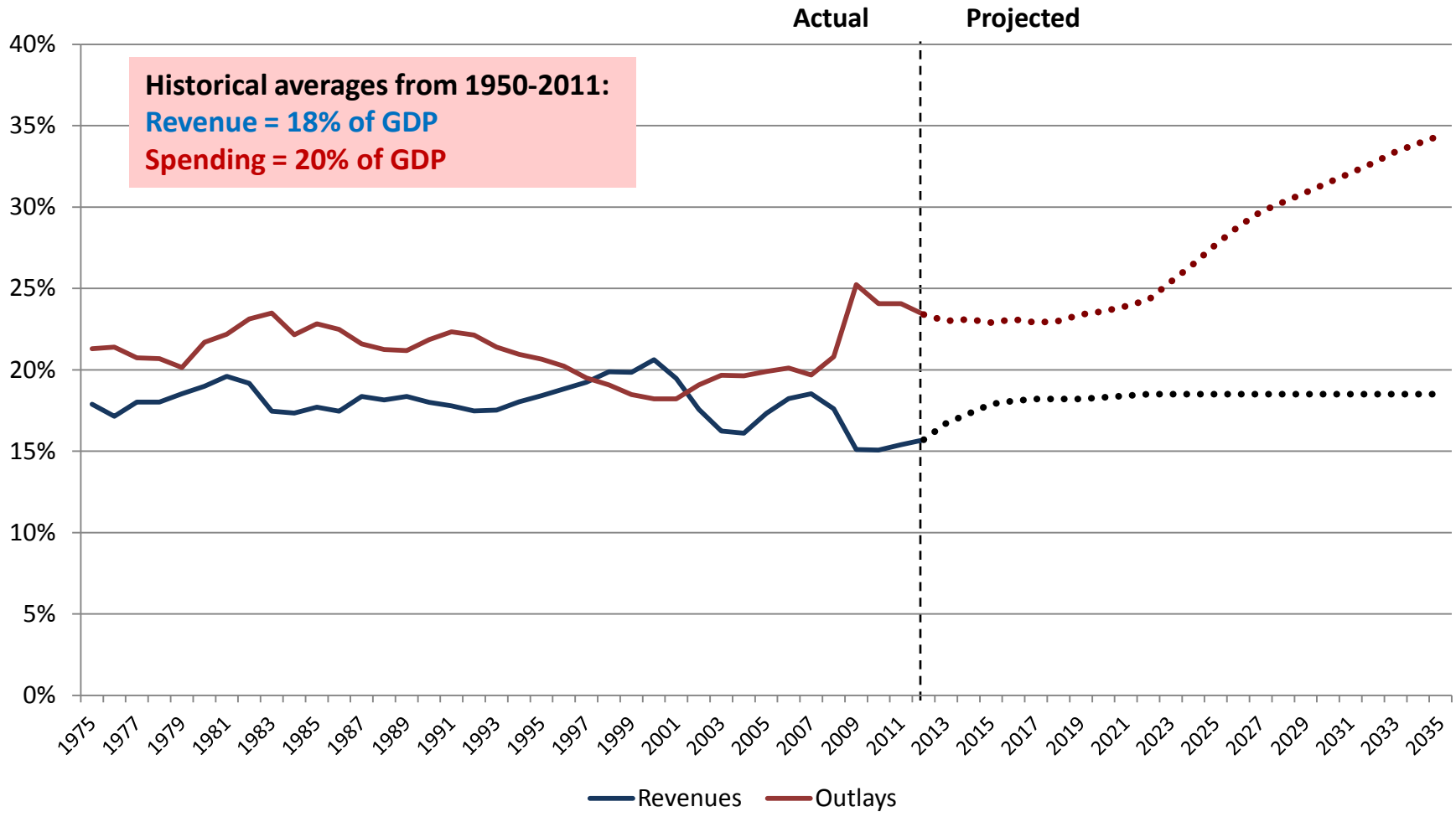
As a percentage of GDP



Sources: Congressional Budget Office and Old Dominion University Economic Forecasting Project.

Federal Revenues and Outlays, 1975 – 2035

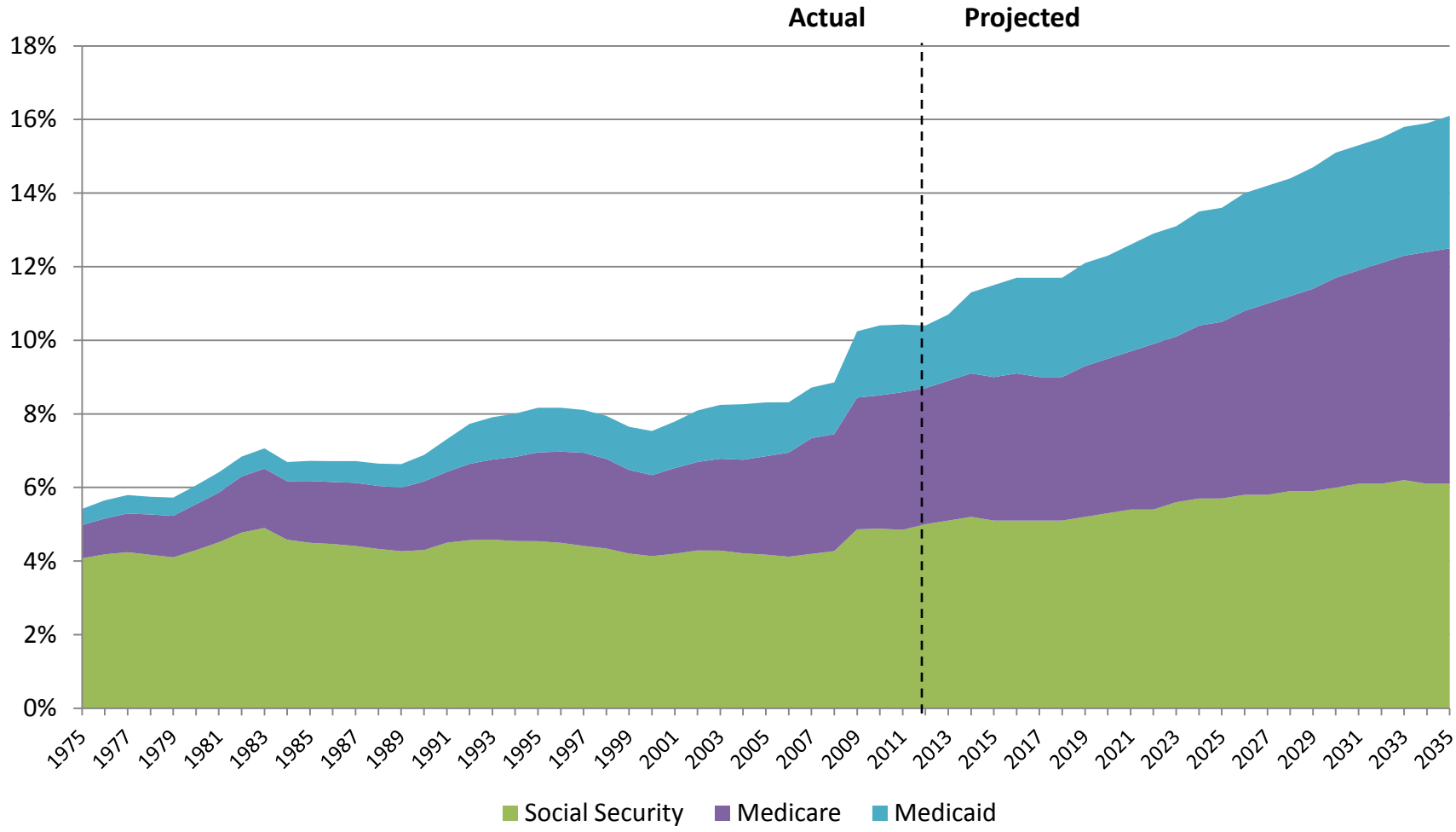
As a percentage of GDP



Sources: Congressional Budget Office and Old Dominion University Economic Forecasting Project.

Federal Entitlement Spending, 1975 – 2035

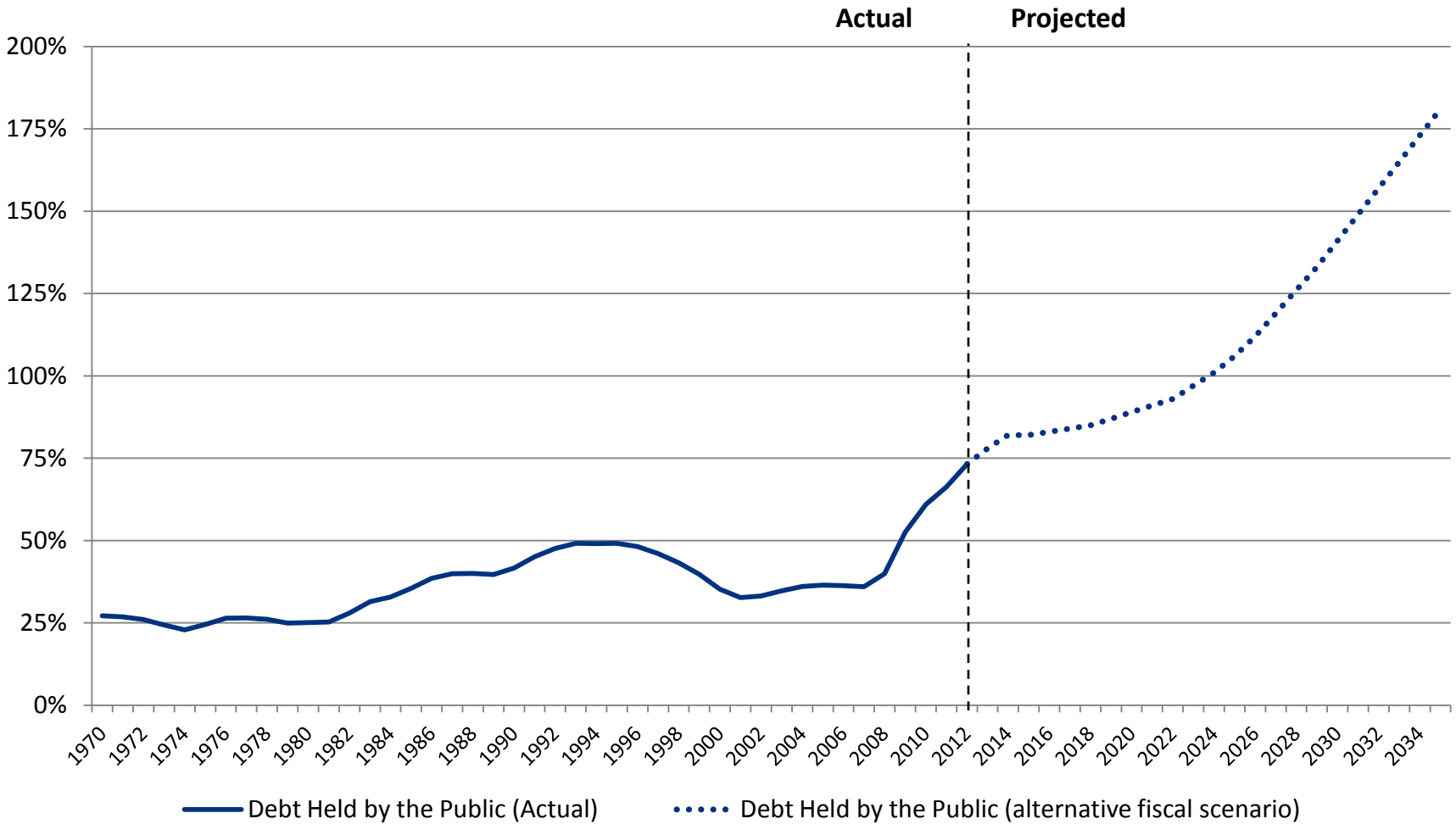
As a percentage of GDP



Sources: Congressional Budget Office and Old Dominion University Economic Forecasting Project.

Debt Held by the Public, 1975 – 2035

As a percentage of GDP



Sources: Congressional Budget Office and Old Dominion University Economic Forecasting Project.

What exactly is the statutory debt limit (or debt ceiling)?

- A limit on the total amount of federal debt that can be outstanding at any point in time
 - Began with the Second Liberty Bond Act of 1917
 - Office of Management & Budget: 76 authorized increases since 1962

- Total federal debt will increase if the government:
 - Issues debt to government accounts in exchange for their surpluses
 - Examples: Social Security Trust Fund, Medicare Trust Fund
 - Called “debt held by government accounts”
 - Sells debt to the public to finance current operations
 - Called “debt held by the public”

More on the debt limit

- Current debt limit is $16.2 trillion
 - Reached on December 31, 2012
- Current revenues fund roughly 75% of current spending
- Consequences to not raising the debt limit:
 - Federal spending will fall by 25% immediately (roughly 6% of GDP)
 - US economy will almost certainly enter a recession
 - Our default risk will increase

Monetary Policy

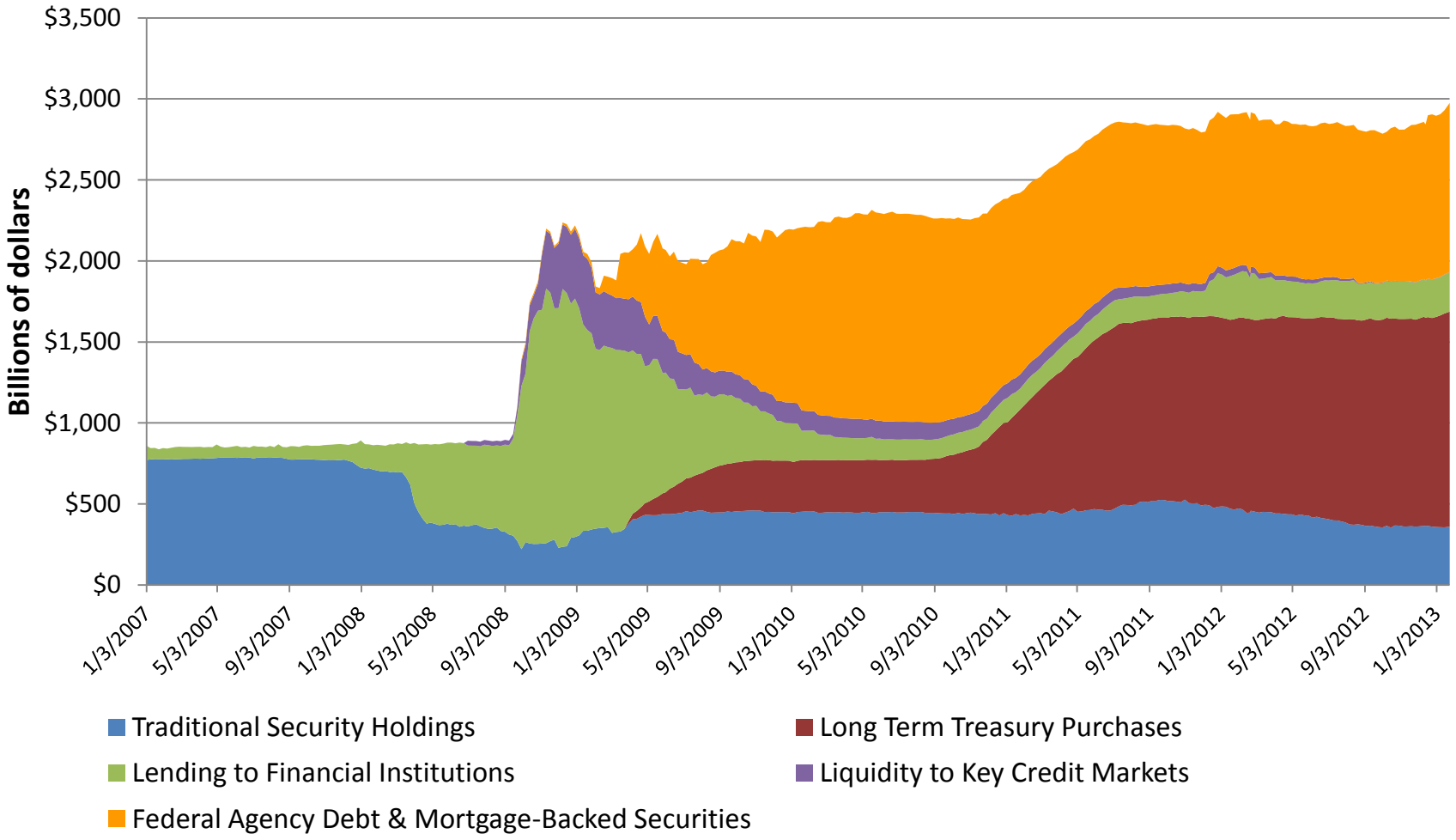
- Federal funds rate target: 0 to 0.25% (November 2008)
 - Expected to stay at this level while unemployment is above 6.5% and while inflation expectations are anchored
 - Announced in their December, 2012 meeting

- Non-traditional forms of monetary policy
 - Balance sheet has expanded from $1 trillion to nearly $3 trillion

Non-traditional Monetary Policy

- Quantitative easing
 - Large-scale purchases of mortgage-backed securities and other agency debt
 - QE1: 3/2009 – 3/2010
 - QE2: 11/2010 – 6/2011
 - **QE3: 9/2012 - ?**
- Maturity Extension Program and Reinvestment Policy
 - "Operation Twist" (ended in 2012)
 - Goal: extend the average maturity of the Fed's Treasury portfolio
- Term deposit facility
 - Program to lower reserve balances of depository institutions
- Foreign currency swap lines
 - Currently extended until February 2014

Federal Reserve Balance Sheet, January 2007 – January 2013



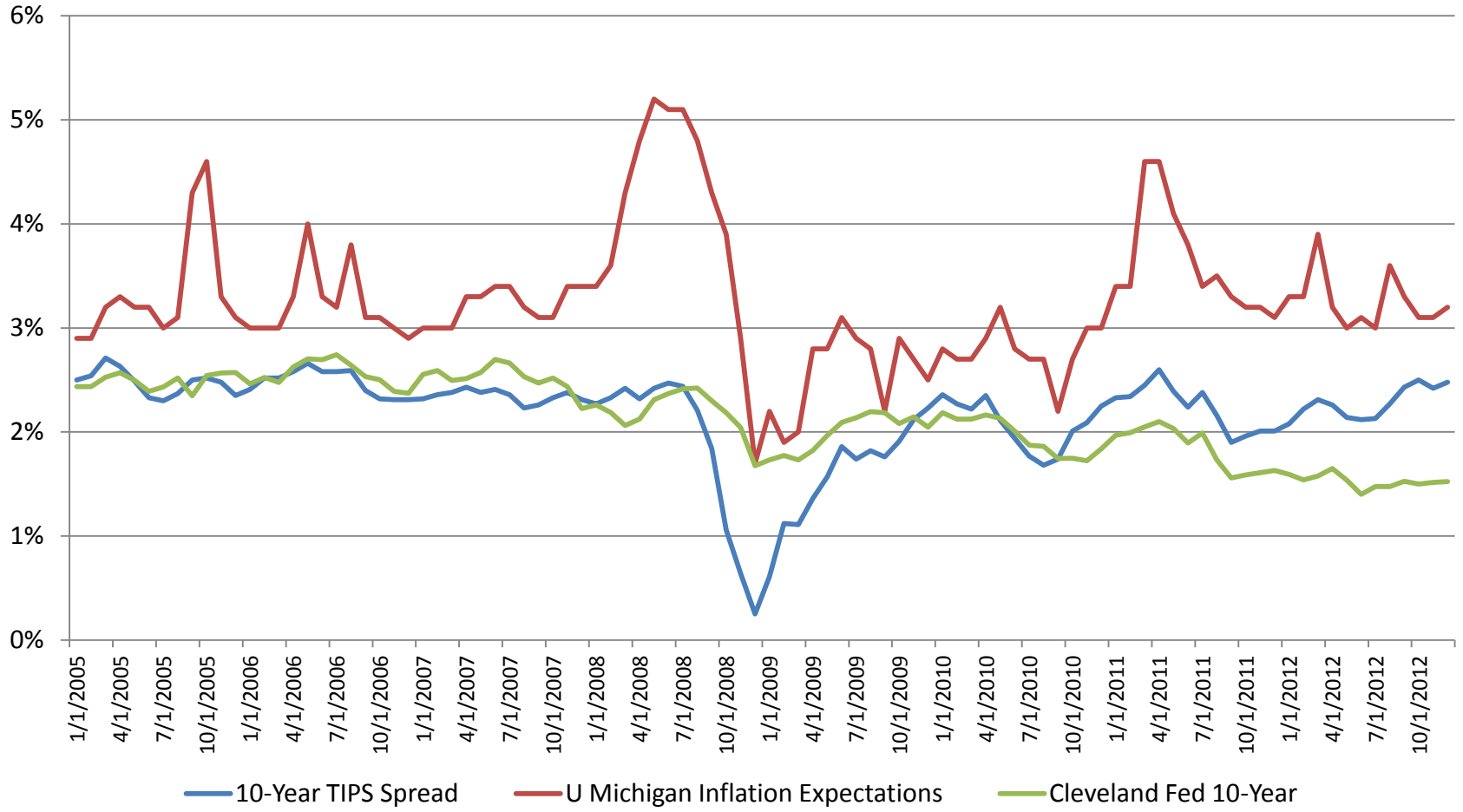
Source: Board of Governors of the Federal Reserve.

Areas of Primary Concern with the Federal Reserve's policies

- Is inflation going to be a short-term problem?
 - Rapid growth in Fed's balance sheet
 - Excess capacity may help keep inflation in check
- How will the Fed "unwind" their balance sheet?
 - Too fast → could slow down the (sluggish) recovery
 - Too slow → inflation
- Are additional and/or new stimulus plans on the horizon?

Inflation expectations

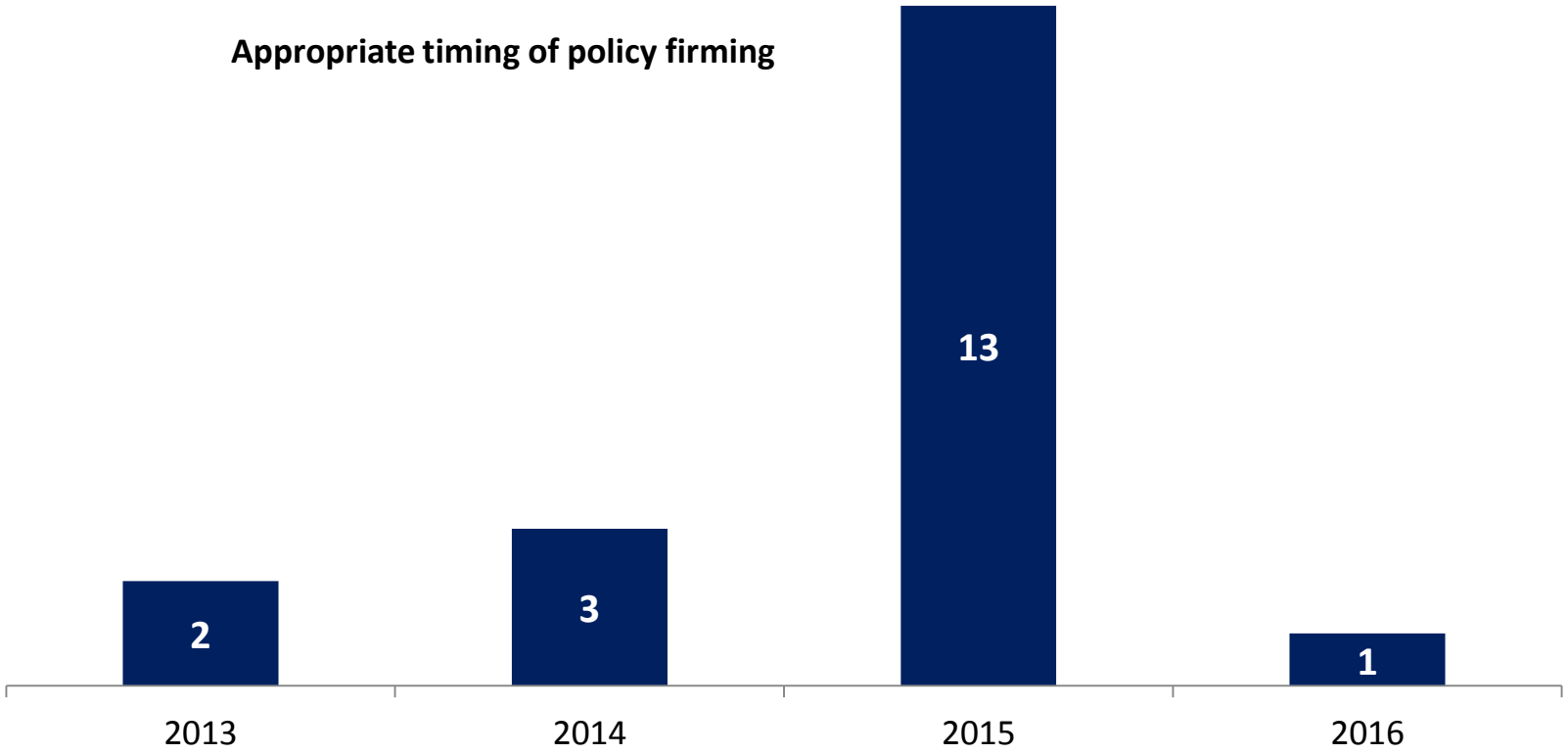
10-Year Time Horizon, 2005:Q1 – 2012:Q4



Source: Federal Reserve Bank of St. Louis, FRED.

Expectations of Fed policy-firming

Survey Results of FOMC Members, December 11-12, 2012



Source: Economic Projections of Federal Reserve Board Members and Federal Reserve Bank Presidents, December 2012.

Downside risks

- Inflation picks up and the Federal Reserve is forced to act
- Recovery in housing slows/stops
- European recession/sovereign debt crisis turns for the worse
- Political uncertainty
- Regulatory uncertainty
 - Dodd-Frank
 - Affordable Care Act

Upside risks

- The Mayans were wrong!
- Energy prices
- Sovereign debt crisis abates
- Housing market stabilizes


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